Bank of Uganda

FINANCIAL STABILITY REPORT

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GLOSSARY

BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
BOU	Bank of Uganda
CAMEL	Capital adequacy, Asset quality, Management, Earnings and Liquidity
CAR	Capital adequacy ratio
CBR	Central bank rate
CI	Credit institution
EAC	East African Community
ECS	Electronic clearing system
EFT	Electronic funds transfer
EMDEs	Emerging markets and developing economies
EMEs	Emerging market economies
EUR	European Union euro
FIA	Financial Institutions Act
FSR	Financial Stability Report
GBP	Great British pound
GDP	Gross domestic product
GWP	Gross written premium
HHI	Herfindahl-Hirschman Index
HMO	Health management organisation
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IRA	Insurance Regulatory Authority of Uganda
KES/KSh	Kenyan shilling
LCR	Liquidity coverage ratio
MDI	Microfinance deposit-taking institution
MNO	Mobile network operator
NPLs	Non-performing loans
RHS	Right-hand side
ROA	Return on assets
ROE	Return on equity
RTGS	Real-time gross settlement
RWF	Rwandan franc
SIPS	Systemically important payment system
SSA	Sub-Saharan Africa
TZS/TSh	Tanzanian shilling
UNISS	Uganda National Interbank Settlement System
URBRA	Uganda Retirement Benefits Regulatory Authority
USD	US dollar
UGX/USh	Uganda shilling
WEO	World Economic Outlook

A Note on Financial Stability

The Bank of Uganda's mandate is to foster macroeconomic and financial system stability. A stable financial system is one in which financial institutions carry out their normal function of intermediating funds between savers and investors, and facilitating payments. By extension, financial instability is a systemic disruption to the intermediation and payments processes, which has damaging consequences for the real economy.

Financial stability analysis involves a continuous assessment of potential risks to the financial system and the development of policies to mitigate these risks. The early detection of risks to the financial system is necessary to give policy makers sufficient lead-time to take pre-emptive action to avert a systemic crisis.

The Financial Stability Report (FSR) is intended to enhance the understanding of financial system vulnerabilities among policymakers, financial market participants and the general public. By making the FSR available to the public, the Bank aims to stimulate debate on policies necessary to manage and mitigate risks to the financial system. A better public awareness of financial system vulnerabilities may itself serve to encourage financial institutions to curb activities which might exacerbate systemic risks and will also help to promote policy reforms to strengthen the resilience of the financial sector.

Foreword and Assessment of Financial Stability

The Financial Stability Report (FSR) of the Bank of Uganda (BOU) is an analysis of the performance and condition of the Ugandan financial system, and the Bank's assessment of potential threats to systemic stability.

External risks to financial stability have not changed materially in the last one year. Global growth increased in the last year, although forecasts point to differing prospects across economies. A number of international vulnerabilities could have implications for domestic stability; particularly macroeconomic shocks including rising oil prices, as well the effect of tighter monetary policy in advanced economies on exchange rate volatility, capital flows and domestic asset prices.

The performance of commercial banks improved in the year to June 2018 as the banking system remained resilient, with adequate capital and liquidity buffers. The ratio of core capital to risk-weighted assets as at June 2018 was 21.8 percent, more than double the statutory minimum of 10 percent. Banks' asset quality also improved, with the ratio of non-performing loans to total loans decreasing from 6.2 percent to 4.4 percent during this period. A key development during the year was the introduction of the IFRS 9 accounting standard, which addresses the accounting of financial instruments and is therefore likely to increase provisioning and capital requirements for banks.

BOU has taken steps to further strengthen the resilience of the banking sector to shocks. First, BOU increased the minimum core capital for banks from 8 percent to 10 percent in May 2018. Secondly, the BOU is amending the liquidity regulations to enforce banks' compliance with the minimum liquidity coverage ratio (LCR) of 100 percent from December 2018. The LCR will also be included in the CAMEL ratings that are used to assess banks' performance during onsite inspections.

Going forward, it is important that the banking system's resilience does not deteriorate in response to cyclical economic changes, growth in asset prices and global financial conditions.

Emmanuel Tumusiime-Mutebile

GOVERNOR

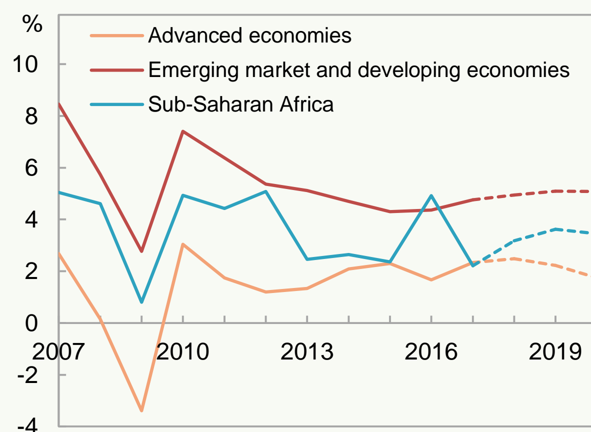
1. The Macroeconomic Environment

Growth in the East African region picked up in 2017 and 2018. However, several near-term risks to the region's financial stability have started to emerge, including normalisation of interest rates in advanced economies which could exacerbate exchange rate pressures and increase capital outflows, as well as the risk of higher inflation driven by rising oil prices. While Uganda's economy remains on a strong growth path, the main concern for domestic financial stability is the growing public debt, more so in the face of rising interest rates.

1.1. Global economic conditions

Global economic growth increased in the year to June 2018, although forecasts point to differing prospects across economies based on differences in fundamentals. The global economy expanded by 3.8 percent in 2017, and the International Monetary Fund (IMF) forecasts that growth will reach 3.9 percent in 2018. Among the advanced economies, growth in the United States is expected to strengthen to 2.7 percent in 2019, underlined by substantial fiscal stimulus together with already robust private demand (Chart 1). In the Euro area, which is the second largest destination for Ugandan exports (Chart 2), the gross domestic product (GDP) growth increased from 1.8 percent in 2016 to 2.3 percent in 2017. However, wider sovereign spreads and tighter financial conditions in the wake of recent political uncertainty are expected to weigh on domestic demand in the Euro area.

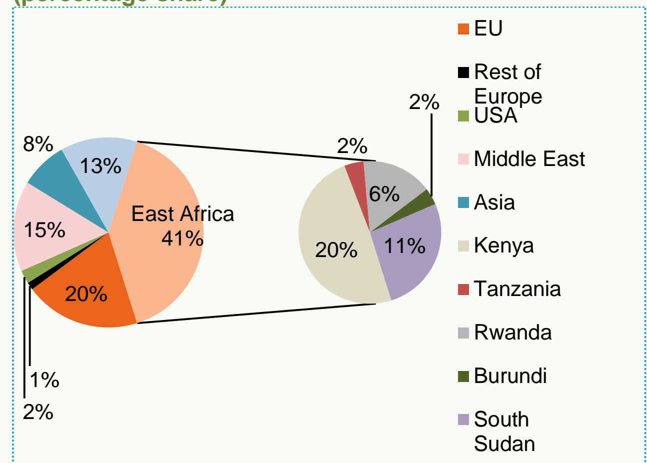
Chart 1: Annual GDP growth for selected economic regions (percent)



Source: IMF WEO Data, April 2018; forecasts from 2017

Globally, inflation picked up largely to reflect supply shortfalls and a rise in global oil prices which increased by 16.0 percent between February 2018 and early June 2018 (Chart 3, IMF World Economic Outlook, July 2018 Update). The increase in fuel prices lifted headline inflation in most advanced and developing economies.

Chart 2: Uganda's direction of trade in 2018 (percentage share)

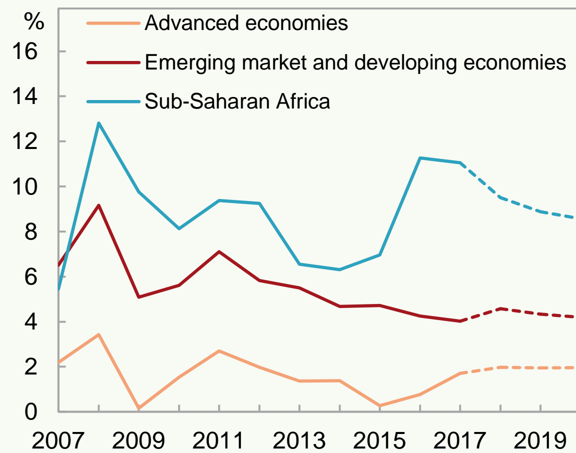


Source: Bank of Uganda

The global developments have several implications for Uganda. In particular, there are expectations that financial conditions will tighten further in advanced economies, including a rise in interest rates. This could contribute to capital outflows from emerging and developing economies, weaken their currencies and affect asset prices, thus impacting financial stability. In addition, the IMF has warned that that economic growth in advanced economies could have peaked and going forward, the balance of risks will shift to the downside. Further, the ongoing trade tariff increases by the United States[1] and retaliatory measures by trading partners could derail growth and depress medium-term growth prospects.

[1] "*Donald Trump signs order for metals tariff plan, prompting fears of trade war*", The Guardian, https://www.theguardian.com/us-news/2018/mar/08/donald-trump-metal-tariffs-trade-war

Chart 3: Global annual inflation rates (percent)



Source: IMF WEO Data, April 2018; forecasts from 2017

1.2. Emerging markets and developing economies

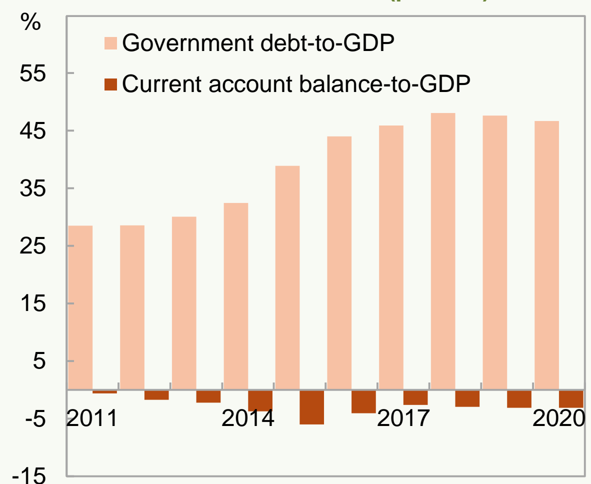
Emerging markets and developing economies (EMDEs) registered an increase in economic growth, from 4.4 percent in 2016 to 4.8 percent in 2017, which is projected by the IMF to rise to 4.9 percent and 5.1 percent in 2018 and 2019 respectively (Chart 1). This growth was attributed to increased investment relative to GDP, as EMDEs leveraged capital inflows from advanced economies.

Nevertheless, EMDEs have experienced powerful crosswinds in recent months including rising oil prices, higher yields in the United States, dollar appreciation, trade tensions, and geopolitical conflict. Growth in China, a major trading partner for Uganda, is projected to moderate from 6.9 percent in 2017 to 6.6 percent in 2018 and 6.4 percent in 2019, as regulatory tightening of the financial sector takes hold and external demand softens amidst higher tariffs by the United States. As of early June 2018, the US dollar strengthened by over 5 percent in real effective terms since February 2018, while some emerging market currencies depreciated sharply due to concerns about financial and macroeconomic imbalances. Core inflation in emerging markets also increased, reflecting pass-through effects from currency depreciation in some cases and second-round effects of higher fuel and agricultural prices in others.

The outlook for individual economies will depend on how these global forces interact with domestic factors. These forces are likely to lead to capital inflow reductions, higher financing costs, and exchange rate pressures in some EMDEs (IMF WEO Update July 2018). Given the close linkages between Uganda and a number of EMDEs, the above sentiments are likely to pass through to Ugandan financial markets.

In Sub-Saharan Africa (SSA), economic activity is expected to continue improving, supported by the rise in commodity prices. For the region, growth is expected to increase from 2.8 percent in 2017 to 3.4 percent in 2018 , rising further to 3.8 percent in 2019 (IMF WEO Update July 2018). Resilient growth throughout Sub-Saharan Africa promises some stability for Uganda, whilst improved performance amongst emerging markets should benefit Uganda's balance of payments through increased trade and capital inflows.

Chart 4: SSA region's government debt and current account balance as a share of GDP (percent)



Source: IMF WEO Data, April 2018; forecasts from 2017

On the other hand, rising current account deficits and public debt threaten financial conditions in the region (Chart 4). While the SSA's current account deficit narrowed in 2017, supported by the improvement in terms of trade, it is forecast to rise due to growing import demand. Also, large fiscal deficits, partly attributed to weak domestic revenue mobilisation and aggressive public infrastructure investment, have resulted in accumulation of high public debt in SSA.

1.3. Macro-financial developments in the East Africa region

Growth in the East African region remained robust in the financial year 2017-18, with significant recovery occurring in Burundi. Regional growth rates averaged 6.3 percent, up from an average of 4.4 percent in the previous year 2016-17 (Table 1). Increased real economic growth was mainly driven by the services sector, agriculture and investment in infrastructure. After two years of contraction following a socio-political crisis between 2014 and 2016, Burundi's economic growth recovered to 2.8 percent in 2016-17 and 4.0 percent in 2017-18.

Table 1: EAC countries' GDP growth, monetary policy and inflation rates (percent)

Financial year	13/14	14/15	15/16	16/17	17/18
Real GDP growth rates (percent)					
Burundi	4.2	-0.4	2.8	2.8	4.0
Kenya	5.4	5.7	5.9	4.9	5.5
Rwanda	5.0	8.6	8.6	3.4	8.9
Tanzania	7.3	7.0	7.0	7.0	7.0
Uganda	5.1	5.2	4.8	3.9	5.8
Central Bank (/monetary) policy rate (percent)					
Burundi	8.0	9.1	7.2	7.1	6.9
Kenya	8.5	11.5	10.0	10.0	9.5
Rwanda	7.0	6.5	6.5	6.3	5.7
Tanzania	12.0	12.0	12.0	12.0	9.0
Uganda	11.0	13.0	15.0	10.7	9.0
Inflation (Annual Average, percent change)					
Burundi	4.4	5.5	5.6	16.1	4.4
Kenya	6.9	6.6	6.3	8.0	5.2
Rwanda	1.4	2.8	5.5	4.8	2.9
Tanzania	5.6	4.8	6.8	5.0	4.0
Uganda	2.6	4.9	5.9	6.3	2.1

Source: EAC central banks

Inflation rates in the East African Community (EAC) countries reduced to an average of 3.5 percent in 2017-18 from 8.1 percent in the previous year, with all countries registering single digit inflation. The more conducive weather conditions that followed the droughts experienced in 2016 allowed for increased agricultural production, and this supported a substantial easing of inflationary pressure across the countries. Consequently, central banks in the region pursued more accommodative monetary policies to further support growth. For example, Rwanda reduced the monetary policy rate by 62 basis points to 5.7 percent, while Uganda and Kenya eased the central bank rate (CBR) by 100 basis points and 50 basis points to 9.0 percent and 9.5 percent respectively, over the same period.

Looking forward, growth in the EAC region is projected to remain strong in the medium term, driven by public infrastructure investment, and manufacturing and mining sectors. Downside risks to growth amongst the EAC partner states include shocks from rising oil prices, and capital flows tilting away from developing countries for the increasing returns in the less risky advanced economies. A significant financial risk to Uganda from the EAC region, originates from the continuation of ongoing conflicts in South Sudan which may further affect the financial condition of domestic exporting firms in Uganda.

Fiscal conditions

Across the EAC region, the ratio of the fiscal deficit to GDP remained high during 2017-18 (Table 2). This was mainly on account of weak domestic resource mobilisation and increased public infrastructure investments. In particular, borrowing for public infrastructure investments led to marked increases in general government gross debt across the EAC. The average government debt–to–GDP ratio increased to 46.5 percent in 2017-18 up from 44.0 percent in the previous year; this ratio for Kenya remained the highest across the EAC countries at 58 percent, partly as a result of energy infrastructure projects, and the implementation of the first phase of the Standard Gauge Railway project (worth KSh.398.1 billion and equivalent to 6.1 percent of GDP). Uganda's government debt–to–GDP ratio rose to 41.6 percent in June 2018, an increase of 390 basis points from the June 2017 position.

Table 2: Government fiscal balance, revenue and gross debt for EAC countries (percent of GDP)

Financial year	13/14	14/15	15/16	16/17	17/18
Fiscal balance, excl. grants (percent of GDP)					
Burundi	-0.2	-2.4	-2.3	-4.6	-2.8
Kenya	-1.6	-2.9	-3.1	-2.7	-2.7*
Rwanda	-13.2	-12.5	-9.7	-10.6	-10.2
Tanzania	-4.8	-4.0	-3.6	-1.9	-2.5
Uganda	-1.1	-1.3	-0.9	-1.1	-1.3
General government revenue (percent of GDP)					
Burundi	21.0	16.7	15.7	16.5	23.9
Kenya	19.8	19.2	18.8	18.7	19.0
Rwanda	16.5	17.6	18.8	20.1	21.0
Tanzania	12.8	12.1	13.5	14.0	13.7
Uganda	11.8	13.2	13.8	14.1	14.2
General government gross debt (percent of GDP)					
Burundi	31.0	39.8	44.0	47.0	47.0*
Kenya	45.9	50.2	53.2	59.0	59.0*
Rwanda	30.6	32.2	34.7	38.9	45.0
Tanzania	34.3	35.0	35.1	40.5	41.6
Uganda	27.9	31.6	34.8	37.7	41.6

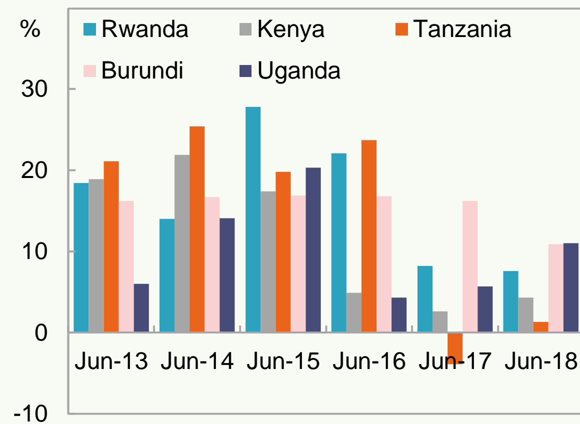
*Source: EAC central banks. *Current financial year figures were not yet available; hence previous financial year figures were carried forward.*

Given the investment momentum and ongoing commitments in public infrastructure across the region, government debt is expected to increase, which may have implications for debt sustainability, crowding-out of private sector credit, and financial stability. Therefore, maintaining government debt within sustainable levels will be important to the stability of the region. In the event that the debt levels reach unsustainable levels, the sovereign's debt could be subjected to downgrades, which would affect yields, interest rates and increase the costs of borrowing for the private sector.

Financial performance of banks in the EAC region

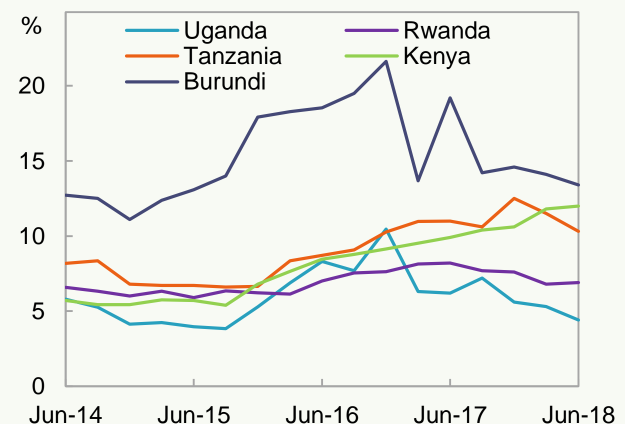
Bank lending in all East African countries grew in 2017-18, with Uganda registering the highest annual growth of 11 percent (Chart 5). This was largely as a result of eased supply side constraints, especially in Tanzania and Uganda where asset quality improved. The region's annual average growth rate of credit to the private sector increased to 7.0 percent up from 5.7 percent in the previous year, and this is expected to boost economic activity in the region.

Chart 5: Annual growth rate in bank credit to the private sector in the EAC region (percent)



Source: EAC central banks; growth rates for Burundi are up to March 2018

Chart 6: Quarterly NPL ratio for banks in the EAC region (percent)



Source: EAC central banks

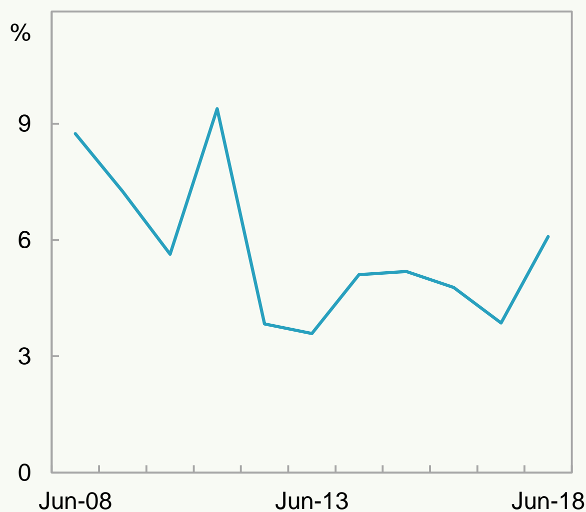
During the year, the ratio of non-performing loans (NPLs) to total gross loans (NPL ratio) dropped for all the East African countries, with the exception of Kenya and Rwanda; Kenya registered the highest NPL ratio of 12 percent in June 2018 (Chart 6). Regarding capital, banks in East Africa held adequate capital to absorb shocks, with the regulatory total capital-to-risk-weighted assets ratio averaging 20.8 percent at the end of June 2018. Banks' profitability in the region rose during the year, after a few years of low profitability, with the average return on assets rising from 1.9 percent to 2.0 percent between June 2017 and June 2018. In addition, average return on equity increased from 12.2 percent to 13.2 percent within the same period. In Kenya, profitability

reduced, mainly reflecting narrowing interest rate margins and the interest rate cap regime[2].

1.4. Uganda's macro-financial developments

Uganda's GDP expanded by 6.1 percent in the year to June 2018, which was higher than the 3.9 percent registered in the previous year ended June 2017 (Chart 7). While there was an improvement across all sectors, the services sector registered the highest growth of 7.7 percent. Industrial and agricultural sectors grew by 6.1 percent and 3.8 percent respectively.

Chart 7: Annual GDP growth for Uganda (percent)



Source: Uganda Bureau of Statistics

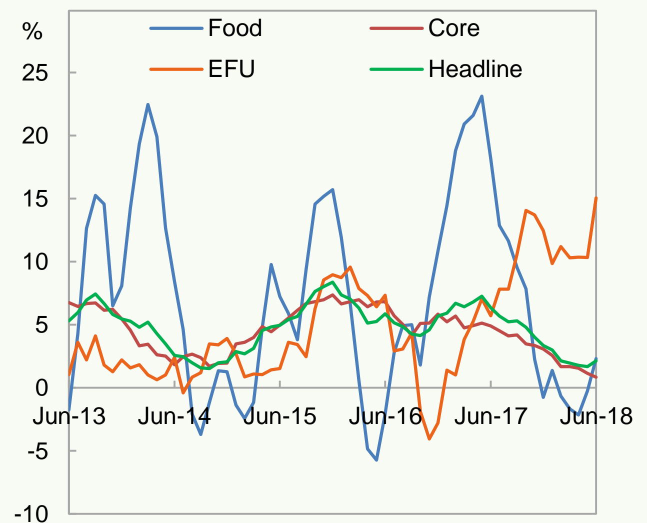
Uganda's economic growth has been strong since the second half of 2017, supported by the global economic upturn and easing of domestic monetary policy. The outlook is for growth to improve to 6.5 percent in the financial year 2018-19, sustained by robust domestic demand growth, public infrastructure investments, improving agricultural productivity and recovery in foreign direct investment. Furthermore, improved global economic performance is expected to boost labour remittances into the Ugandan economy, which crossed the billion-dollar mark in the year to June 2017 to US$1,287.0 million and remained high at US$1,083.8 in the year to June 2018.

[2] "*The impact of interest rate capping on the Kenyan economy (Draft paper)*", Central Bank of Kenya, March 2018

Inflation and interest rates

Annual headline inflation for the year ending June 2018 eased to 2.1 percent from 6.3 percent in June 2017 (Chart 8). Notably, the bumper crop production during the financial year 2017-18, enabled by the favourable weather conditions, significantly dampened inflationary pressures, with annual food crop inflation decreasing from 18.1 percent in June 2017 to 2.3 percent in June 2018.

Chart 8: Domestic annual inflation rates (percent)

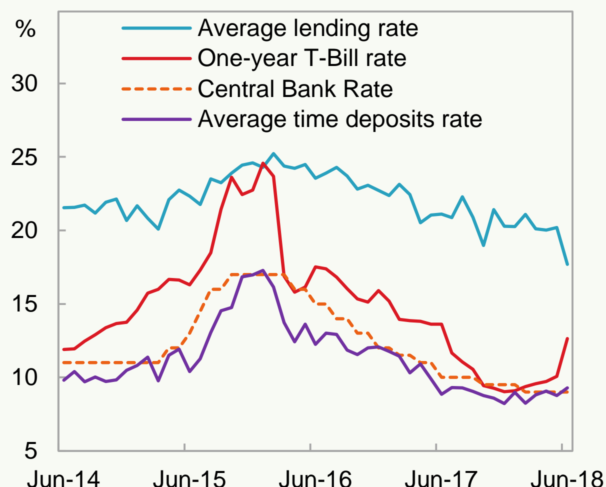


Source: Bank of Uganda

With inflation down, Bank of Uganda eased monetary policy by reducing the CBR to 9.0 percent from 10.0 percent in June 2017. Over the same period, other key interest rates moved in tandem with the CBR, with the commercial banks' weighted average lending rate decreasing from 21.1 percent to 17.7 percent (Chart 9).

However, BOU projects core inflation to rise above the target of 5 percent within the next year, driven by rising oil prices and coupled with a weaker shilling exchange rate and higher indirect taxes. A key risk to the inflation outlook is the exchange rate, which remains vulnerable to the possibility of tighter global financial conditions as well as strong domestic demand. These risks are likely to lead to a tightening of monetary policy in the short-term, which could affect lending rates, increase non-performing loans and affect the debt servicing capacity of marginal borrowers.

Chart 9: Key monthly interest rates (percent)

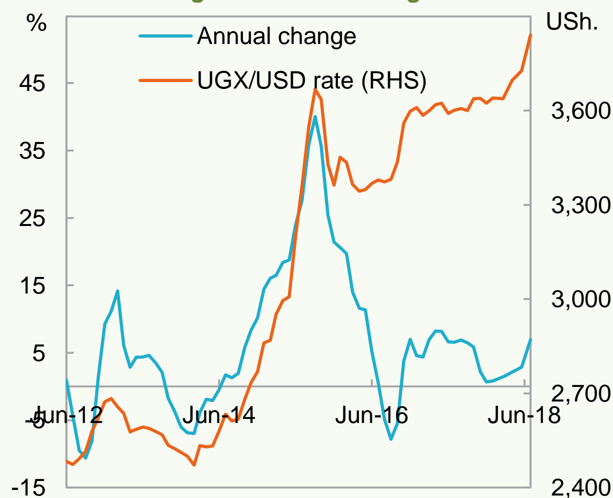


Source: Bank of Uganda

The external sector

In the year to June 2018, exchange rate risks to banking sector performance increased, driven by relative volatility in the foreign exchange market in the first half of 2018. The Ugandan shilling depreciated to USh.3,840 per US dollar in June 2018 as compared to USh.3,591 per US dollar in June 2017, which represents an exchange rate depreciation of 6.9 percent on an annual basis (Chart 10). This partly reflected the weakening of Uganda's balance of payments, as the current account deficit-to-GDP ratio widened to 5.8 percent from 3.4 percent in 2016/17, on account of increased import demand which was exacerbated by rising oil prices, thus exceeding growth in exports.

Chart 10: Shilling/US dollar exchange rate movements

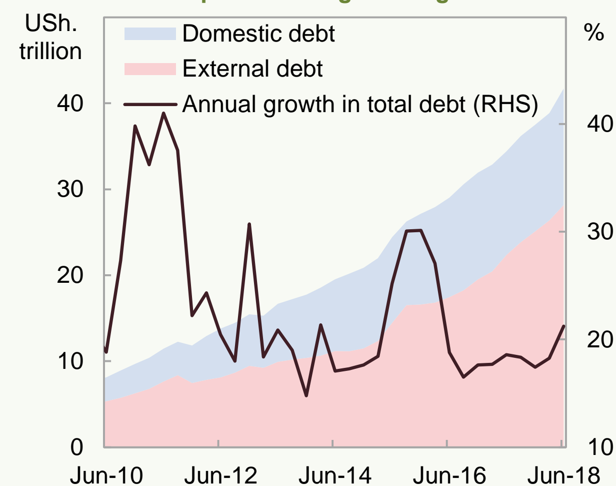


Source: Bank of Uganda

Fiscal performance

Over the year ended June 2018, total public debt increased by 21.2 percent from USh.34.4 trillion to USh.41.7 trillion (Chart 11). This was faster than the increase in the previous year of 19.9 percent. The increase in public debt was mainly driven by the external debt component, which grew by 26.0 percent. Regarding domestic debt, government increased domestic borrowing by 12.4 percent in the financial year 2017-18, compared to the 3.9 percent growth in 2016-17. Financial institutions continued to be the largest lenders to the government; banks contributed 42.5 percent while pension and provident funds contributed 40.6 percent. If the government continues to borrow from the financial sector at this rate, this may result in crowding out banks' lending to the private sector going forward.

Chart 11: Developments in Uganda's government debt



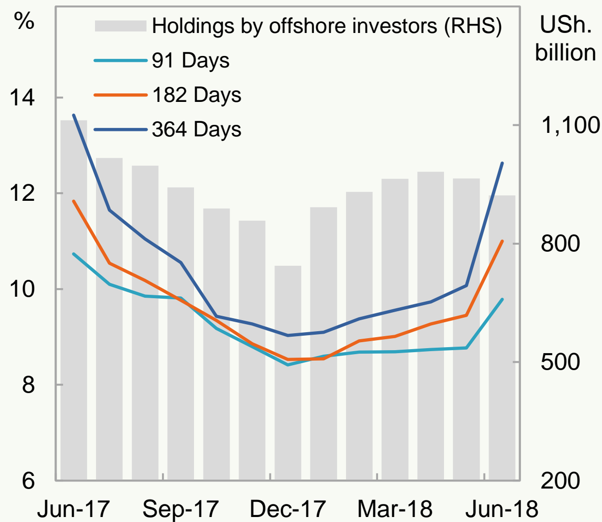
Source: Bank of Uganda

Yield on treasury securities

Yields on government securities followed the trend of the CBR, reducing from 10.7 percent, 11.8 percent and 13.6 percent for the 91-day, 182-day and 364-day treasury bills respectively in June 2017 to 9.8 percent, 11.0 percent and 12.6 percent for the 91-day, 182-day and 364-day treasury bills respectively in June 2018. On the other hand, offshore investors' holdings of treasury securities reduced over the financial year 2017-18, from 9.2 percent to 6.8 percent (Chart 12). Generally, offshore investors shifted from shilling assets to foreign currency assets as the US dollar strengthened against other

currencies. While this minimises the vulnerability to foreign investors' portfolio allocation shifts, it deprives the country of financial resources. Indeed, a similar trend was observed with banks in Uganda reducing their shilling assets and opting for more placements with non-resident banks (refer to Chapter 2 of this Report).

Chart 12: Yields on treasury securities and their holdings by offshore investors



Source: Bank of Uganda

While external financing needs make Uganda vulnerable to market volatility, Bank of Uganda has sufficient foreign reserve holdings to absorb external shocks, such as a sudden withdrawal of offshore funds. The total investment by offshore investors in treasury bills securities as a ratio of official foreign reserves decreased from 12.3 percent as at end-June 2017 to 11.3 percent as at end-June 2018. Overall, as at the end of June 2018, Uganda's foreign exchange reserves stood at US$3,220.7 million, equivalent to 4.6 months' of import cover.

1.5. Conclusion

In the year to June 2018, risks to financial stability from Uganda's macro-financial environment remained moderate. This was on account of an upturn in economic growth, a fall in inflation, public investments in infrastructure and increased aggregate demand which improved loan performance.

However, the outlook for 2018-19 sees a likely build up in macroeconomic risks, especially from rising inflationary pressures driven by oil prices, and domestic risks arising from the increasing fiscal deficits and exchange rate volatility.

2. KEY DEVELOPMENTS IN UGANDA'S BANKING SECTOR

The performance of Uganda's banking sector improved over the year to June 2018, notably in asset growth which was driven by increased lending activity, and higher profitability due to reduced loan losses. Banks started to ease lending standards in 2018 but remain mindful not to compromise credit quality. There are also concerns about the effect of the IFRS 9 accounting standard on provisioning and profitability in the medium term.

2.1. Growth of the banking sector

The banking sector, which comprises 24 commercial banks, registered increased growth in the year to June 2018. Total bank assets grew by 10.2 percent, up from 9.0 percent in the previous year (Table 3). The growth in assets was driven mainly by a pickup in lending, investment in government securities and placements with non-resident financial institutions. Notably, bank lending strengthened, with annual loan growth rising from 0.9 percent in June 2017 to 11.0 percent in June 2018.

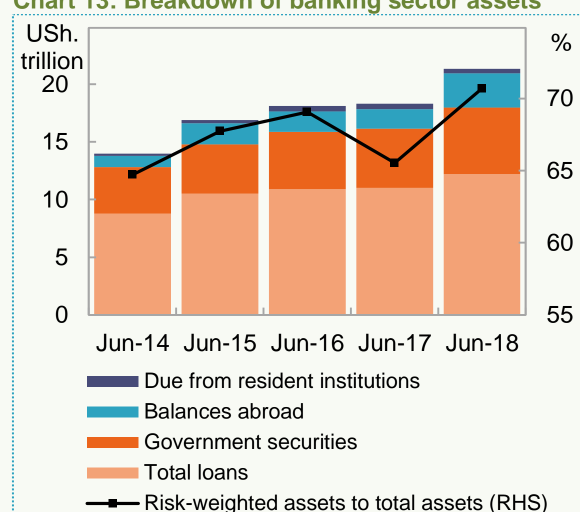
Table 3: Annual changes in banks' assets

	*5-year average	June 2015	June 2016	June 2017	June 2018
Total assets					
Values (USh. trillion)	**22.0**	21.6	22.8	24.8	27.4
Growth (%)	**11.4**	15.9	5.5	9.0	10.2
Central government securities					
Values (USh. trillion)	**4.6**	4.3	5.0	5.1	5.8
Growth (%)	**13.5**	6.1	15.9	3.5	12.3
Loans					
Values (USh. trillion)	**10.4**	10.5	10.9	11.0	12.2
Growth (%)	**9.2**	19.7	3.7	0.9	11.0
BOU securities					
Values (USh. trillion)	**0.9**	0.2	0.5	2.0	1.6
Growth (%)	**128.9**	-79.4	141.7	347.0	-22.1
Due from banks abroad					
Values (USh. trillion)	**1.7**	1.8	1.8	1.8	3.0
Growth (%)	**17.0**	85.9	-2.5	-0.6	68.9

*Source: Bank of Uganda. *The averages were obtained using quarterly data*

Strong growth was also registered in banks' holdings with financial institutions abroad, which rose by 68.9 percent. Most banks in the sector increased their nostro account balances with foreign banks during the first half of 2018, mainly driven by inflows from non-government organisations, multinationals and other companies. Reflecting this trend, foreign currency deposits increased by 11.0 percent between March 2018 and June 2018.

Chart 13: Breakdown of banking sector assets



Source: Bank of Uganda

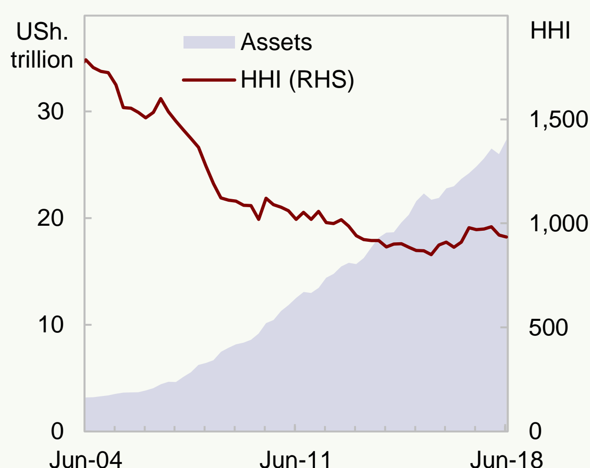
Analysis of the banking industry's market concentration[3] using the Herfindahl-Hirschman Index[4] (HHI) revealed that the industry remains competitive. The HHI decreased from 969.4 at June 2017 to 934.2 at June 2018 (Chart 14), indicating that asset growth in the industry during this period was more widespread amongst banks. The market share of the

[3] *In the case of Uganda's banking sector, we use the share of a bank's assets as a proxy for market share.*

[4] *The Herfindahl-Hirschman Index (HHI) is a commonly accepted measure of market concentration. HHI is calculated as the sum of squares of the market shares of all firms in a sector. HHI below 1000 indicates a highly competitive industry while HHI below 1500 indicates an industry that is not concentrated.*

three largest banks reduced from 42.8 percent at June 2017 to 40.4 percent at June 2018.

Chart 14: Evolution of the Ugandan banking sector's market concentration



Source: Bank of Uganda

2.2. Capital adequacy

The banking sector remained well capitalised in the year to June 2018. All commercial banks met the minimum core and total capital adequacy ratios of 10.0 percent and 12.0 percent respectively. However, the industry's total regulatory and tier one capital adequacy ratios decreased from 23.6 percent and 21.4 percent at June 2017 to 21.8 percent and 19.7 percent at June 2018 respectively (Table 4).

Table 4: Banking system's capital adequacy ratios (percent)

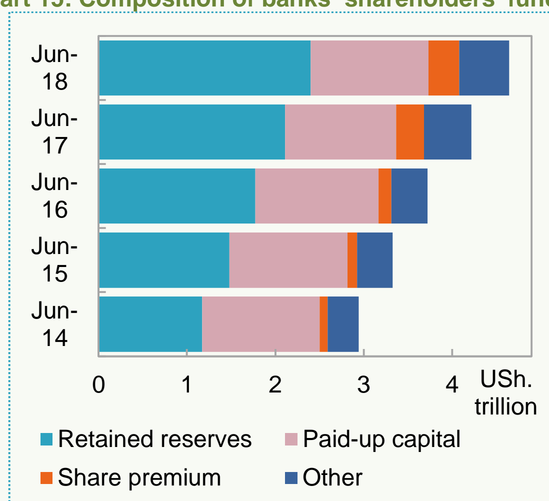
	*5-year average	June 2015	June 2016	June 2017	June 2018
Total capital adequacy ratio	22.4	21.2	21.7	23.6	21.8
Tier 1 capital adequacy ratio	19.9	18.8	19.0	21.4	19.7
Leverage ratio	11.2	11.0	10.8	11.5	11.1

*Source: Bank of Uganda. *The averages were obtained using quarterly data*

The leverage ratio (ratio of regulatory tier one capital to total assets plus off-balance sheet items), which is another indicator of banks' capital adequacy, also decreased from 11.5 percent at June 2017 to 11.1 percent at June 2018. The trends in these ratios resulted from a higher rate of growth in assets, particularly risk-weighted assets, in comparison to the rate of growth in capital. Asset growth in the year was, therefore, financed more by deposit liabilities than by capital.

Banks' total shareholders' capital increased in nominal terms by 10.1 percent, from USh.4.2 trillion at June 2017 to USh.4.7 trillion at June 2018 (Chart 15). This was aided by an increase in profits of 21.5 percent in the first half of 2018. Retained earnings also increased by 13.8 percent during this period.

Chart 15: Composition of banks' shareholders' funds



Source: Bank of Uganda

2.3. Funding and liquidity conditions

Ugandan banks fund their assets mainly through retail deposits. By analysing changes in the banking sector's funding sources, we can assess whether mismatches exist between key assets and liabilities which could increase liquidity pressures in the sector. Overall, indicators show that the volume and cost of bank retail and wholesale funding improved during the year to June 2018. Liquidity indicators also show that banks have adequate liquid assets.

Table 5 shows that the annual change in core funding[5] exceeded the annual increase in key assets by USh.136.8 billion at the end of June 2018. The computation of the funding gap takes retail deposits to be the main source of funding for the key assets as

[5] *Banks' core funding includes total deposits, amounts due from domestic and foreign financial institutions and retained earnings.*

presented in the table. For the year ending June 2018, the absolute growth in key bank assets was higher than that in deposits, leaving a funding deficit of USh.125.5 billion. However, the increase in retained earnings of USh.290.8 billion was more than enough to offset this deficit to give a surplus of USh.136.8 billion. The implications of the surplus funding are that there were very moderate risks arising from balance sheet funding operations in the year to June 2018.

Table 5: Annual changes in banks' core funding sources and assets (USh. billion)

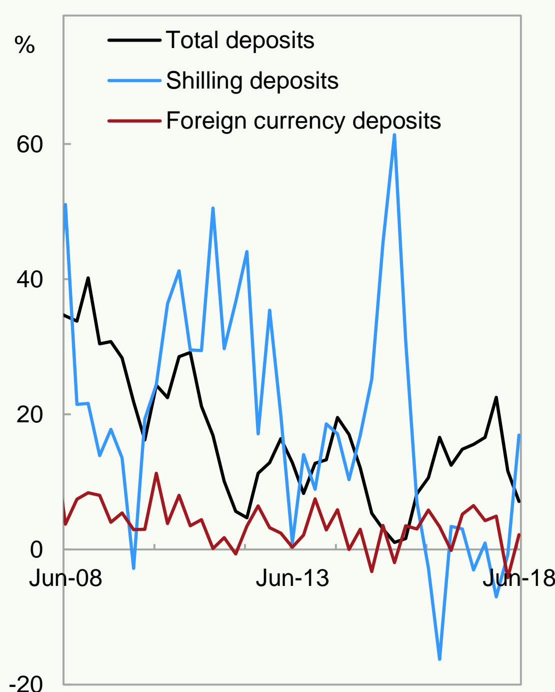
	June 2015	June 2016	June 2017	June 2018
Deposits	2,044.5	1,087.3	1,603.6	2,140.9
LESS (key assets):				
Loans	1,733.7	389.7	101.9	1,207.3
Securities	246.3	682.2	1377.5	28.4
Due from resident institutions	86.8	194.7	10.2	-105.4
Due from non-resident institutions	841.8	-44.8	-85.1	1042.6
Cash assets	149.4	-40.3	111.2	93.4
	-1013.4	**-94.2**	**87.9**	**-125.5**
ADD (wholesale funding):				
Due to resident institutions	-177.4	-194.7	72.4	-17.7
Due to non-resident institutions	-127	34.3	-4.6	-10.7
	-1,317.8	**-254.6**	**155.7**	**-154.0**
ADD (equity component):				
Retained earnings	306.9	295.1	334.7	290.8
Funding gap	**-1010.9**	**40.5**	**490.4**	**136.8**

Source: Bank of Uganda

Retail funding conditions

Retail deposits remain the main source of funding, comprising 84.8 percent of total liabilities in the year to June 2018. Deposits grew by 12.5 percent in the year to June 2018, compared to 10.3 percent in the year to June 2017. Deposit growth was driven by shilling deposits which grew by 15.2 percent up from 1.2 percent in the year to June 2017 (Chart 16).

Chart 16: Annual growth in banks' retail deposits (percent)



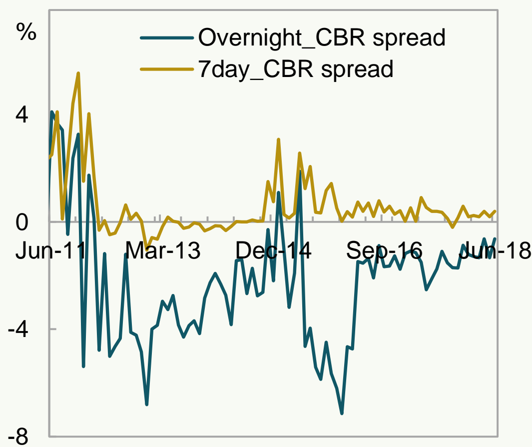
Source: Bank of Uganda

The cost of deposits increased in the year to June 2018. The weighted average deposit rate increased from 2.5 percent at June 2017 to 2.6 percent at June 2018. The average savings deposit rate increased from 2.3 percent to 3.5 percent over the period, while the average time deposit rate (7-12 months) remained largely stable at 9.3 percent.

Wholesale funding

The main sources of wholesale funding for Uganda's banking system include unsecured borrowing in the domestic interbank market, borrowing in the foreign currency swaps market, and loans from financial institutions abroad. Risks from wholesale funding stayed modest as they remained a small percentage of total bank funding. Total unsecured borrowing in the interbank market increased from USh.22.5 trillion in the year to June 2017 to USh.30.0 trillion in the year to June 2018 (Chart 18). The volatility of interest rates in the interbank market was subdued in the year to June 2018, with spreads on overnight interbank deals narrowing (Chart 17). Despite increased interbank trading activity, the ratio of interbank borrowings to total deposits remained low at 1.6 percent at June 2018.

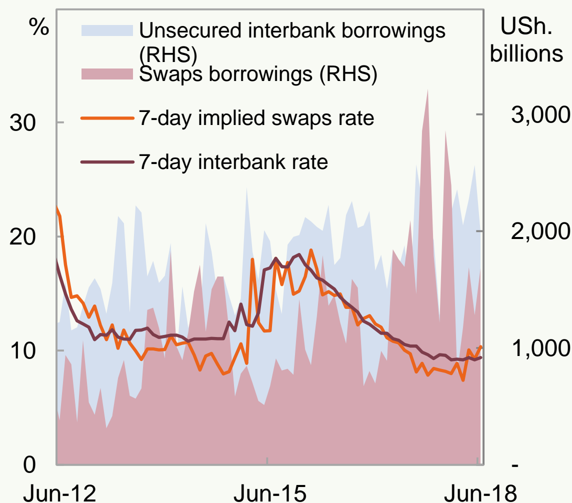
Chart 17: Spreads between interbank rates and the CBR (percent)



Source: Bank of Uganda

Borrowing activity through currency swaps also increased in the year to June 2018. The average implied overnight and 7-day swap rates[6] increased from 8.9 percent and 9.7 percent at June 2017 to 9.7 percent and 10.3 percent at June 2018 respectively (Chart 18).

Chart 18: Wholesale market funding rates (percent)



Source: Bank of Uganda

However, banks' wholesale funding as a percentage of total funding stood at 6.4 percent as at June 2018, a decline from 8.3 percent as at June 2017. The changes observed in the wholesale funds market reflected favourable liquidity conditions within the banking system during this period, as well as the easing of monetary policy, as the CBR declined from 10.0 percent in June 2017 to 9.0 percent in June 2018.

Indicators of bank liquidity

Liquidity risk in the banking system was modest in the year to June 2018, with banks maintaining adequate liquidity buffers. The build-up of excess liquidity in the banking industry that was observed in 2017 slowed down in 2018 as banks started to lengthen the maturity profile of their asset portfolio through lending and investment in longer-term government securities.

Table 6: Key indicators of bank liquidity (percent ratios)

Indicator	June 2015	June 2016	June 2017	June 2018
Total loans to total deposits	72.8	70.2	64.2	63.4
Liquid assets to total deposits	46.4	43.4	50.1	46.6
Liquid assets to total assets	31.1	29.6	34.6	32.8
Industry LCR	354.4	188.3	252.9	372.4

Source: Bank of Uganda

The liquid assets-to-total deposits ratio declined from 50.1 percent in June 2017 to 46.6 percent in June 2018; however, this is more than double the regulatory minimum requirement of 20 percent (Table 6). Total loans as a share of total deposits declined from 64.2 percent in June 2017 to 63.4 percent in June 2018, boosted by strong deposit growth compared to the annual loan growth. The liquidity coverage ratio (LCR) for the aggregate industry balance sheet stood at 372.4 percent at June 2018, compared to 252.9 percent at June 2017. With the exception of one bank, all banks had sufficient high quality liquid assets to withstand a 30-day stress period.

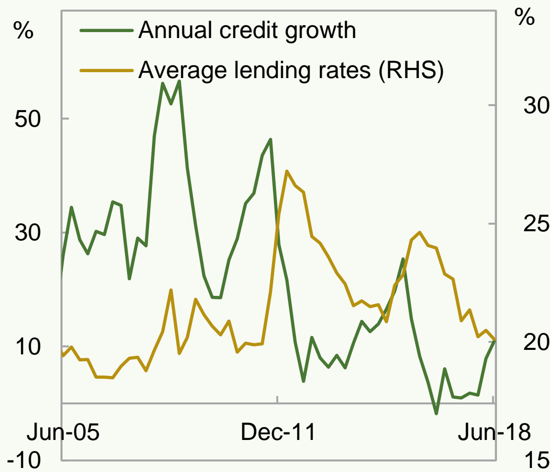
2.4. Banks' lending activity

The year to June 2018 registered a recovery in bank lending to the private sector. Total outstanding credit increased by 11.0 percent, in comparison to 0.9 percent in the year to June 2017 and 3.7 percent in the year to June 2016 (Chart 19). In terms of currency denomination, shilling loans increased by

[6] *An implied currency swaps rate is the cost of funds that a lending counterparty in a swaps transaction attaches to its funds in determining the forward exchange rate for a given currency swap. It is referred to as implied because it is unobservable, but is inferred from the forward and spot exchange rates of given market transactions.*

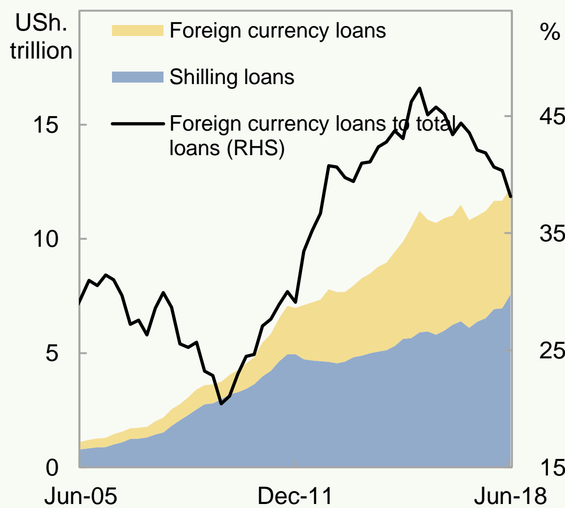
18.6 percent in the year to June 2018, up from 6.5 percent in the year to June 2017.

Chart 19: Annual credit growth and average lending rates (percent)



Source: Bank of Uganda

Chart 20: Stock of loans by currency denomination

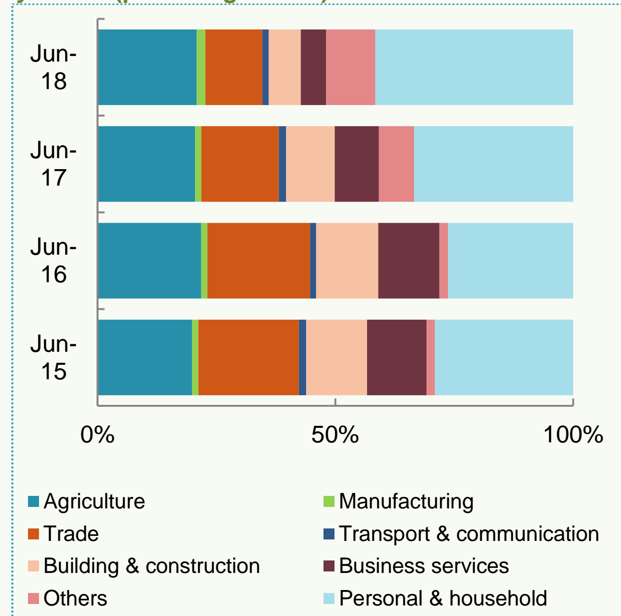


Source: Bank of Uganda

On the other hand, growth of foreign currency-denominated loans remained subdued, rising by only 0.5 percent in the year to June 2018. Given that the local currency depreciated by 8.0 percent against the US dollar between June 2017 and June 2018, the growth rate of foreign currency loans partly reflects valuation effects as opposed to absolute growth in the loan portfolio. The ratio of foreign currency loans to total loans continued to decline to 38.1 percent at June 2018 from 42.1 percent at June 2017.

The recovery in bank lending was due to a combination of reduced supply-side constraints and increased demand. The cost of borrowing reduced as bank lending rates fell significantly during the year. The average bank lending rates on shilling loans fell from 21.1 percent in June 2017 to 17.7 percent in June 2018 (Chart 19). BOU's quarterly bank lending survey reports for the last three quarters to June 2018 indicated that banks eased credit standards to all sectors except real estate, which they attributed to improved macroeconomic conditions, the reduction in the monetary policy rate which alleviated funding costs, and increased competition in the financial sector, among other factors. Consequently, the total number of loan applications approved by banks in the year to June 2018 increased by 15.9 percent, compared to an increase of 12.0 percent in the year to June 2017.

Chart 21: Loan applications received annually by banks by sector (percentage share)



Source: Bank of Uganda

Demand for credit increased in the year to June 2018, though at a slower rate compared to the previous year. The total number of loan applications received by banks in the year to June 2018 increased by 5.2 percent, a lower rate than that recorded for the year to June 2017 of 6.4 percent (Chart 21). The growth in demand was mainly from households, the manufacturing and agriculture sectors. On the other hand, business services, construction and real estate, and trade and commerce all recorded larger declines in demand for credit over the year, in comparison to the previous year.

Changes in sectoral lending

In the year to June 2018, banks maintained a sectoral lending pattern similar to that witnessed in the same period in 2017. The building and construction sector, trade and commerce sector and personal loans continued to account for the largest share of total loans as in the previous year with 20.1 percent, 19.2 percent and 18.9 percent respectively at the end of June 2018 (Table 7).

Table 7: Analysis of sectoral lending by banks (percent)

		*5-year average	June 2015	June 2016	June 2017	June 2018
Agriculture	Share	9.9	9.3	9.8	11.3	12.2
	Growth rate	22.5	21.3	9.3	17.1	19.8
Manufacturing	Share	14.0	16.1	14.6	13.3	13.2
	Growth rate	7.8	40.6	-5.5	-8.1	9.8
Trade & Commerce	Share	18.8	19.5	17.9	18.9	19.2
	Growth rate	2.5	12.8	-4.9	6.4	12.5
Building & Construction	Share	22.4	23.2	23.6	20.5	20.1
	Growth rate	6.5	19.8	5.2	-12.2	8.7
Business Services	Share	4.3	4.7	3.7	4.2	4.0
	Growth rate	7.1	29.2	-18.6	14	5.5
Personal & Household Loans	Share	16.9	15.2	15.9	18.5	18.9
	Growth rate	17.0	5.1	8.4	17	13.8
Transport & Communication	Share	6.1	5.4	5.2	7.1	6.8
	Growth rate	10.1	5.7	15.6	43.1	-3.5

*Source: Bank of Uganda. *The averages were obtained using quarterly data*

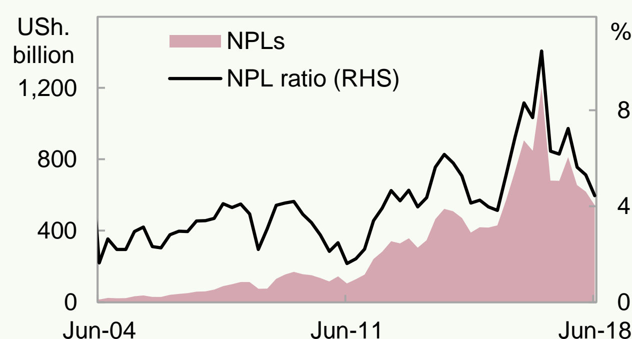
Notably however, the fastest increase in credit during the period under review was to the agriculture and household sectors. Loans to agriculture grew at a rate of 19.8 percent, while those to households increased by 13.8 percent. A significant share of the personal loans is composed of unsecured salary loans. In addition, credit growth in the manufacturing and building and construction sector recovered from the negative rates witnessed in the year to June 2017. Nevertheless, data shows that credit standards to the construction and real estate sector were tightened throughout the year and demand also remained subdued.

Looking forward, credit growth is expected to remain robust over the next year. Demand is likely to be supported by the expansion in economic activity bolstered by increased government investment for the fiscal year 2018-19. Credit supply is also expected to remain strong as banks look to build their asset base and the overhang of bad loans continues to reduce.

2.5. Bank asset quality

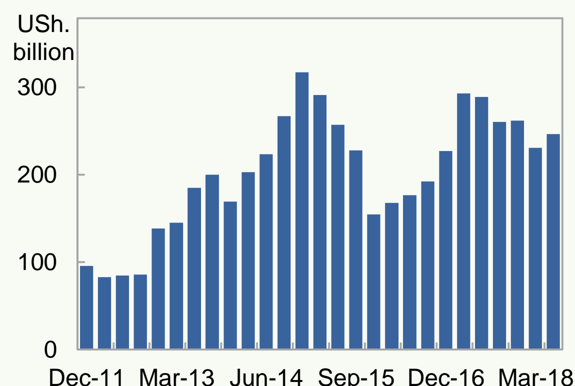
In our last Report for June 2017, BOU predicted that credit quality would improve in the short- to medium-term. Indicators show that asset quality improved over the year to June 2018, supported by banks' continued efforts to clean up their loan books through write-offs. Banks' aggregate NPL ratio (non-performing loans to total gross loans) decreased from 6.2 percent at June 2017 to 4.4 percent at June 2018 (Chart 22). In nominal terms, NPLs decreased by USh.136.8 billion in the year to June 2018. Annual write-offs remained historically high but reduced from 289.1 billion in the year to June 2017 to USh.246.5 billion in the year to June 2018 (Chart 23).

Chart 22: Evolution of banks' NPLs



Source: Bank of Uganda

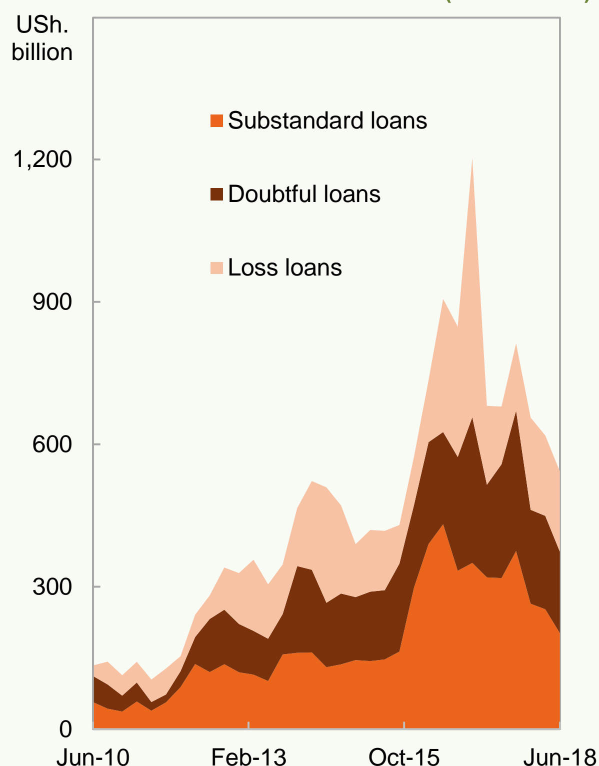
Chart 23: Annual bank write-offs



Source: Bank of Uganda

Furthermore, the analysis of loan classification in the year to June 2018 indicates substandard loans and doubtful loans reduced by USh.115.8 billion and USh.68.4 billion, respectively, in the same period (Chart 24). However, loss loans increased by USh.47.4 billion despite the high level of loan write-offs. This suggests that the change in NPLs could partly have been attributed to more write offs as opposed to recoveries.

Chart 24: Classification of banks' NPLs (USh. billion)



Source: Bank of Uganda

Asset quality analysis by currency and sector

Both the local and foreign currency industry NPL ratios decreased between June 2017 and June 2018 (Table 8). As at the end of June 2018, the industry NPL ratio for shilling loans was 4.3 percent, down from 5.9 percent in the previous year, while the industry foreign currency NPL ratio also reduced from 6.6 percent to 4.6 percent. Shilling-denominated NPLs declined by 12.7 percent from USh.374.6 billion in June 2017 to USh.326.9 billion in June 2018. Similarly, foreign currency-denominated NPLs declined by 29.2 percent from USh.305.0 billion to USh.216.0 billion. On a sectoral basis, NPL ratios across all sectors declined. However, the agriculture sector recorded the highest NPL ratio of 11 percent, which was mainly attributed to its foreign currency denominated portfolio.

Table 8: NPL ratios by currency and business sector (percent)

		*5-year average	June 2015	June 2016	June 2017	June 2018
Industry	Overall	5.9	4	8.3	6.2	4.4
	USh.	5.8	3.8	8.3	5.9	4.3
	FX.	5.9	4.2	8.3	6.6	4.6
Agriculture	Overall	10.5	6.2	17.4	12.5	11.0
	USh.	6.4	4.6	11.8	9.3	5.7
	FX.	14.0	7.5	21.9	15.1	16.5
Manufacturing	Overall	2.7	4.3	2.3	2.7	1.4
	USh.	5.0	7.8	6	5.2	2.9
	FX.	1.6	2.7	0.6	1.3	0.5
Trade & commerce	Overall	19.8	3.7	9.1	5.5	5.2
	USh.	8.0	2.6	10.8	7	6.9
	FX.	4.8	5.2	7	3.5	1.8
Building & Construction	Overall	5.8	3.6	11.1	4.7	3.4
	USh.	6.5	2.6	11.6	6	4.1
	FX.	5.0	4	10.7	3.4	2.6
Personal & Households	Overall	3.5	4.1	3.4	4.2	2.8
	USh.	3.5	4	3.8	4.2	2.8
	FX.	4.8	5.7	1.9	2.3	2.9
Transport & Communication	Overall	7.2	6	11	9.3	3.1
	USh.	6.1	7.7	15.6	3.1	1.7
	FX.	9.1	5.1	7	16.9	5.6
Mining & Quarrying	Overall	17.2	7.2	0.8	31.5	5.2
	USh.	16.2	0	1.7	17.5	12.1
	FX.	17.8	18.9	0.1	38.9	0.8
Business Services	Overall	5.7	2.7	2.1	14.6	6.1
	USh.	6.5	3.5	3.3	10.4	5.4
	FX.	6.2	1.6	0.1	21.4	7.3

*Source: Bank of Uganda. *The averages were obtained using quarterly data*

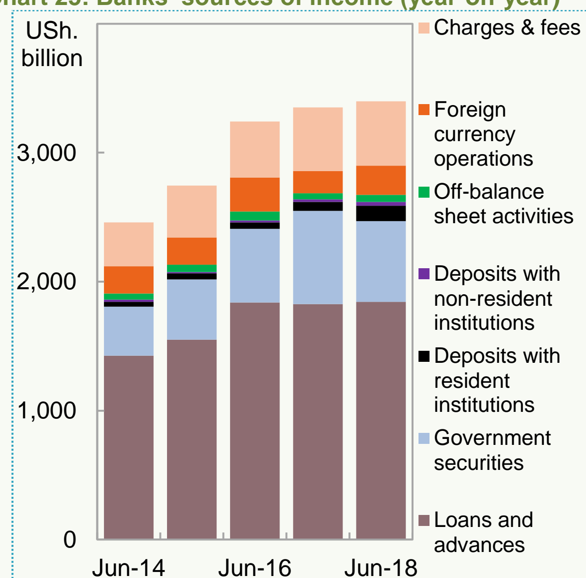
Looking forward to 2019, BOU's leading business indicator shows optimistic expectations for businesses in the major sectors of agriculture, construction, manufacturing and trade. Increased economic activity is expected to enhance the balance sheets of companies and households and thus contribute positively to improved asset quality. However, further increases in interest rates could heighten credit default rates. In addition, the IFRS 9 accounting standard, which came into effect in January 2018, could lead to an increase in provisioning for expected losses, which could then pass through to bank profitability and capital. The effect of this standard is explained further in Chapter 5 of this Report.

2.6. Earnings and profitability

Profitability of the banking industry improved in the year to June 2018 compared to the previous year. Banks' aggregate net after-tax earnings increased by 82.6 percent from USh.404.5 billion in the year to June 2017 to USh.738.7 billion in the year to June 2018. The primary reason for the improved profitability of banks was a large fall in expenses on provisions for bad debt.

Total income increased by USh.46.6 billion in this period, mainly on account of gains of USh.54.1 billion from foreign currency operations, as a result of the depreciation of the local currency in the quarter to June 2018. Banks also registered interest income gains of USh.40.0 billion from placements in financial institutions in Uganda, while interest income from loans and advances increased by USh.17.5 billion over this period. As a share of total income, income from total loans and advances accounted for 50.1 percent while earnings on government securities accounted for 17.0 percent of total income in the year to June 2018.

Chart 25: Banks' sources of income (year-on-year)



Source: Bank of Uganda

A reduction in banks' total expenses of USh.286.5 billion was attributed to a decline of USh.335.8 billion in provisions for bad debt. However, operating expenses mainly from wages and staff costs, rose by USh.125.8 billion which increased the overhead-to-income ratio from 48.4 percent in the year from June 2017 to 51.2 percent in the year to June 2018.

Key ratios of bank profitability improved in the year to June 2018. The aggregate return on assets (ROA) and return on equity (ROE) increased from 1.7 percent and 10.2 percent at June 2017 to 2.8 percent and 16.7 percent at June 2018 respectively (Table 9). A DuPont[7] breakdown shows that the improvement in ROA and ROE was mainly attributed to increased net profit margins as a result of decreased costs in provisioning for bad debt.

Table 9: Indicators of banks' profitability (year-on-year analysis)

	*5-year average	June 2015	June 2016	June 2017	June 2018
Net profit after tax (USh. billion)	488.4	556.3	485.6	404.5	738.7
ROA (%)	2.4	2.8	2.2	1.7	2.8
ROE (%)	14.3	17.7	13.8	10.2	16.7
ROE DuPont decomposition					
Net profit margin (%)	15.4	18.9	13.9	11.1	20.1
Asset turnover (%)	15.3	14.6	15.7	15.3	14.1
Equity multiplier	6.1	6.4	6.3	6.0	5.9
Number of loss-making banks		7	5	6	7
Net interest margin (%)	11.6	10.9	11.9	12.4	11.5
Cost-to-income ratio (%)	77.1	73.8	78.4	81.6	72.8
Overhead-to-income ratio (%)	48.1	48.1	47.9	48.4	51.2

*Source: Bank of Uganda. *The averages were obtained using quarterly data*

Asset turnover, however, declined as the growth in assets (10.2 percent), outstripped the growth in total income (1.3 percent). As banks grow their asset portfolios and clean up their loan books, interest income could grow proportionately with assets, thus increasing asset turnover and improving return on equity. Maintaining good asset quality, and thus low

[7] *DuPont analysis is a common form of financial statement analysis, which decomposes the return on equity (ROE) or return on assets (ROA) ratio to determine the underlying drivers of profitability within the financial statements of an entity.*

provisions for bad debt, will be crucial to keeping profit margins high. In the midst of an increasingly competitive environment, therefore, banks should maintain good lending standards to ensure sustainable profitability. A key moderating factor is likely to be the introduction of IFRS 9 that became effective in 2018, which might increase credit loss provisioning through its forward-looking approach.

2.7. Exposure to exchange rate risk

Overall exposure to exchange rate movements remained low in the year to June 2018, despite the growth in the share of foreign currency denominated components of the balance sheet. The increase in foreign currency assets was mainly on account of banks' placements abroad, as discussed in Section 2.1.

Table 10: Indicators of banks' exposure to foreign currency (percentage ratios)

Indicator	June 2015	June 2016	June 2017	June 2018
Forex exposure to regulatory tier 1 capital	-5.7	-6.2	-7.0	-5.2
Foreign currency assets to total assets	38.1	35.1	31.2	33.1
Foreign currency loans to total loans	46.2	45.1	42.1	38.1
Foreign currency deposits to total deposits	42.2	40.9	37.5	38.4
Foreign currency loans to foreign currency deposits	79.8	77.5	72.1	62.9

Source: Bank of Uganda

Nevertheless, the aggregate foreign currency open position relative to core capital remained within the regulatory limit of +/- 25 percent as at the end of June 2018, and the ratio of foreign currency loans to foreign currency deposits was well below the 80 percent limit as stipulated in the BOU Foreign Currency Business Guidelines (2010).

2.8. Performance of domestic systemically important banks

Three commercial banks were identified as domestic systemically important banks (DSIBs) as at the end of December 2017; ***Stanbic Bank***, ***Standard Chartered Bank*** and ***DFCU Bank***.

Overall, indicators show that the DSIBs remained financially sound over the year to June 2018. The three banks accounted for 40.4 percent of total bank assets at June 2018, a decline of 2.4 percent from June 2017. The DSIBs' capital adequacy ratios remained above minimum regulatory limits, signifying strong resilience. Also, overall asset quality for DSIBs improved over the year to June 2018.

Capital adequacy

The DSIBs were adequately capitalised as at the end of June 2018. All three banks met the minimum regulatory requirements for both the total capital and core capital adequacy ratios. The aggregate total capital adequacy ratio of the DSIBs, however, decreased from 20.8 percent at June 2017 to 18.0 percent at June 2018, while the core capital adequacy ratio decreased from 18.3 percent at June 2017 to 15.9 percent at June 2018. The declines were mainly on account of increased risk-weighted assets.

Table 11: Comparison of selected financial soundness indicators of DSIBs to aggregate industry indicators (percent)

	Jun-16		Jun-17		Jun-18	
	DSIBs	Industry	DSIBs	Industry	DSIBs	Industry
Total DSIBS assets to total industry assets	38.2	N/A	42.8	N/A	40.4	N/A
Total capital adequacy ratio	19.3	21.7	20.8	23.6	18.0	21.8
Core capital adequacy ratio	15.8	19.0	18.3	21.4	15.9	19.7
Liquid assets to total deposits	44.5	43.4	49.4	50.1	41.9	46.6
NPLs-to-total gross loans ratio	9.1	8.3	5.9	6.2	5.1	4.4
Return on assets	3.3	2.2	3.2	1.7	3.1	2.8
Return on equity	24.3	13.8	21.0	5.8	19.4	16.7

Source: Bank of Uganda

Funding and liquidity

As at June 2018, DSIBs maintained adequate funding bases supported by retail deposits and sufficient liquid assets. Total deposits for DSIBs accounted for 83.3 percent of their total liabilities. However, deposit growth decreased from 25.4 percent in the year to June 2017 to 9.9 percent in the year to June 2018. Shillings deposits growth declined from 25.4 percent at June 2017 to 9.9 percent at June 2018, while foreign currency deposits growth declined from 18.0 percent at June 2017 to 16.7 percent at June 2018. The monthly LCR results for June 2018 indicated that each individual DSIB held sufficient high quality liquid assets to sustain the bank through a 30-day stress period. Liquid assets as a percentage of total deposits declined from 50.7 percent to 41.9 percent at June 2018. This ratio, however, remained above the minimum required regulatory ratio of 20.0 percent, demonstrating sufficient liquidity.

Asset quality

The asset quality of DSIBs improved between June 2017 and June 2018. The aggregate NPL ratio for the DSIBs decreased from 6.0 percent at June 2017 to 5.1 percent at June 2018, as aggregate NPLs decreased from USh.273.5 billion at June 2017 to USh.264.4 billion at June 2018.

Earnings and profitability

The profitability of DSIBs declined in the year to June 2018. The return on assets decreased from 3.2 percent in the year to June 2017 to 3.1 percent in the year to June 2018, while the return on equity decreased from 21.0 percent in the year to June 2017 to 19.4 percent in the year to June 2018. Relative to the industry, the gap in profitability narrowed as return on assets and return on equity for DSIBs was 1.3 and 2.7 percentage points higher in the year to June 2018 respectively, compared to 1.5 and 10.8 percentage points in the year to June 2017. This was indicative of a general recovery in profitability in the industry.

2.9. Performance of other deposit-taking financial institutions

Other deposit-taking financial institutions in Uganda's financial sector include credit institutions (CIs) and microfinance deposit-taking institutions (MDIs).

Credit institutions

Overall, the CIs were adequately capitalised as at June 2018. However, the overall core capital adequacy ratios decreased from 24.3 percent at June 2017 to 20.9 percent at June 2018, while the total capital adequacy ratio decreased from 26.0 percent at June 2017 to 22.5 percent at June 2018.

CIs registered increased growth in assets, from 12.6 percent growth recorded in the year to June 2017 to 25.8 percent growth in the year to June 2018. This was attributed to accelerated credit growth, as growth in gross loans increased from 8.2 percent recorded in the year to June 2017 to 28.3 percent growth in the year to June 2018. Like commercial banks, CIs mainly rely on retail deposits and shareholders' capital to fund their assets. Retail deposits accounted for 85.8 percent of total liabilities at June 2018 and registered growth of 28.9 percent in the year to June 2018, compared to 14.5 percent growth recorded in the year to June 2017. The loan-to-deposit ratio therefore declined from 77.6 percent at June 2017 to 77.3 percent at June 2018. These indicators show that the CIs were able to adequately fund the growth in loans using the deposit base.

The profitability of CIs improved in the year to June 2018. CIs reported net profits of Ush.3.2 billion in this period, an increase from USh.270.1 million in the year to June 2017 and losses of USh.1.2 billion in the year to June 2016. ROA and ROE ratios stood at 1.3 percent and 7.4 percent respectively, in comparison to 0.1 percent and 0.3 percent in the year to June 2017. Increased profitability was driven by accelerated lending as interest on loans and advances increased by 21.5 percent, in comparison to 7.1 percent in June 2017.

Microfinance deposit-taking institutions

MDIs were adequately capitalised as at June 2018. The overall core capital adequacy ratio increased from 38.9 percent at June 2017 to 44.4 percent at June 2018 while the total capital adequacy ratio increased from 42.3 percent at June 2017 to 48.0 percent at June 2018.

MDIs registered increased growth in assets, but at a subdued rate. Asset growth declined for the past two years, from 22.6 percent in the year to June 2016 to 6.4 percent in the year to June 2017 and 2.5 percent in the year to June 2018. This was attributed to contraction in credit growth, from 25.3 percent recorded in the year to June 2016 to -2.8 percent in the year to June 2017 and -1.5 percent in the year to June 2018. The contraction in credit growth was mainly due to increased risk aversion by MDIs, as NPLs of all MDIs peaked in the year to June 2017. Focus was therefore placed on recovery and cleaning up of the loan portfolio, which resulted in changes to internal credit controls, loan products and strategies. These have constrained credit growth in the short-term. Deposit growth, however, improved from 1.2 percent growth recorded in June 2017 to 7.4 percent growth recorded at June 2018.

The profitability of MDIs improved in the year to June 2018. This was mainly attributed to declining provisions for bad debt (by 28.5 percent) as MDIs cleaned up their books. However, profitability was subdued by the slowdown in credit growth, as interest income declined by 3.4 percent. The ROA and ROE ratios stood at 3.1 percent and 8.6 percent respectively, in comparison to 2.8 percent and 8.8 percent in the year to June 2017. Asset quality improved in the year to June 2018 as indicated by a decline in the aggregate NPL ratio from 5.0 percent at June 2017 to 4.4 percent at June 2018.

2.10. Conclusion

As at the end of June 2018, banks' financial soundness remained strong. Banks recorded significant growth in assets, while the cost of funding reduced and liquidity risk remained low. Asset quality continued to improve but it remains a concern, especially as interest rates start to rise. The profitability of the banking industry improved over the year to June 2018 as a result of improved asset quality, which reduced provisions for bad debt.

Looking ahead, credit quality could be affected by indirect market risks arising from interest rate policy expectations in advanced economies. In addition, there is concern that the implementation of the IFRS 9 accounting standard which is likely to increase asset provisioning, as well as the easing of lending standards by banks, could affect bank profitability and solvency going forward. Nevertheless, banks remain well capitalised to absorb shocks arising from these factors.

3. Financial Infrastructure and Other Financial Corporations

Payment systems are crucial for intermediation in the financial system, promoting financial stability and economic growth. In the year to June 2018, BOU conducted various oversight activities including the analysis of risks in payment systems and monitoring their usage and operational performance. This chapter highlights the oversight and performance of payment systems in Uganda. It also examines the performance of the retirement benefits sector and the insurance industry.

3.1. Performance of payments systems

At the end of June 2018, Uganda's payment systems infrastructure included: the Uganda National Interbank Settlement System (UNISS) – Uganda's Real Time Gross Settlement system; the Electronic Clearing System (ECS) – for cheques, direct debit and credit transfers; and an electronic central securities depository for government securities. Private sector players also provide a number of payment systems and instruments including mobile money, cross-border money remittance and internet banking services.

3.1.1. Uganda National Interbank Settlement System (UNISS)

The UNISS, Uganda's RTGS system, is a systemically important payment system (SIPS). UNISS is designated as SIPS as it processes the largest volume of time-critical, high value payments among banks, facilitates settlement of netted positions from other multilateral settlement systems and connects to similar RTGS systems in East Africa. Direct access to UNISS is currently available to supervised financial institutions. UNISS can be a potential source of contagion, particularly in periods of market stress. It is therefore important to ensure that UNISS operates in a manner that helps reduce systemic risk.

Throughout the year to June 2018, UNISS operated satisfactorily and exhibited a high degree of availability. However, the UNISS operations encountered one major disruption in the month of July 2017 that led to the unavailability of the system beyond the recommended two hours. Nonetheless, all the payments for the day were settled by close of day.

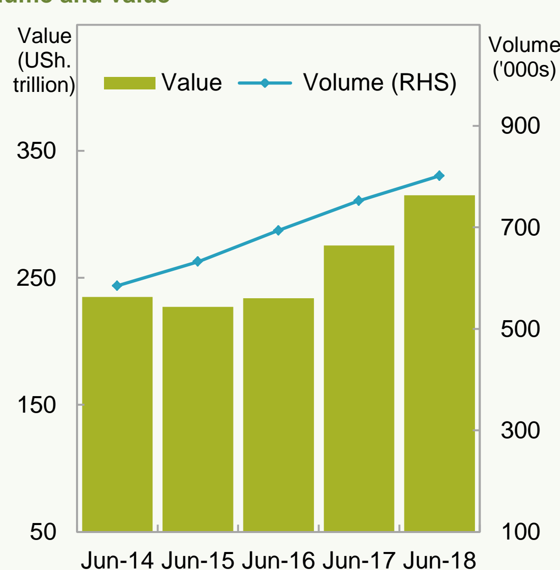
In the year to June 2018, the total value of UNISS transactions both in Ugandan shillings and foreign currency stood at USh.348.9 trillion while the total volume stood at 929,429 transactions. UNISS transactions in Uganda shillings represent 90.3 percent of the total value of all UNISS transactions and 86.2 percent of the total volume of all UNISS transactions.

Table 12: Value of UNISS transactions by currency in the year to June 2018

Currency	EUR	GBP	KES	RWF	TZS	UGX	USD
Value (USh. trillion)	1.3	0.1	1.6	0.0	0.0	315.0	30.9
Proportion (%)	0.4	0.0	0.5	0.0	0.0	90.3	8.9

Source: Bank of Uganda

Chart 26: UNISS transactions in Ugandan shillings by volume and value

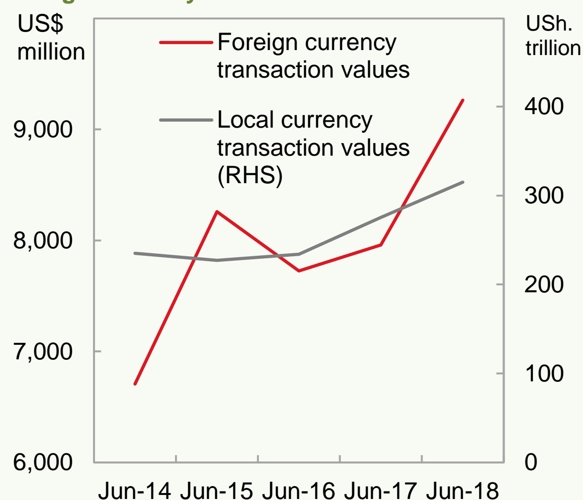


Source: Bank of Uganda

UNISS also settles transactions in select foreign currencies, namely: United States Dollars (USD/$), European Union Euros (EUR/€), the Great British Pound (GBP/£), Kenyan Shilling (KES/KSh), Tanzanian Shilling (TZS/TSh) and Rwandan Franc (RWF). Transactions in the US dollar registered the

highest activity in terms of both value and volumes of foreign currencies settled in the year ending June 2018, with US$9.3 billion settled in 127,909 transactions. The Kenyan shilling recorded the second highest volume and value of transactions with an equivalent of US$425.4 million settled in 7,133 transactions.

Chart 27: Value of UNISS transactions in local and foreign currency



Source: Bank of Uganda

The volumes of transactions denominated in Ugandan shillings through UNISS increased by 6.5 percent from 752,475 to 801,583 in the year to June 2018. However, this growth rate was lower, as compared to 8.5 percent registered in the previous year. The value of these transactions increased by 14.4 percent from USh.275.4 trillion to USh.315.0 trillion in the period under review.

3.1.2. Electronic Clearing System

On 20th April 2018, BOU commenced the operation of an upgraded Electronic Clearing System (ECS). The ECS automates the process of clearing cheques and electronic funds transfer (EFT) transactions, both in Ugandan shillings and the widely used foreign currencies, namely USD, EUR, GBP and KES. The new system provides a cheque truncation capability. Cheque truncation involves exchanging electronic cheque images in the clearing process instead of exchanging actual physical cheques. This eliminates the physical movement of cheques between banks and across bank branches, and thus speeds up the process of cheque clearance, settlement among banks and realisation of funds by the beneficiaries.

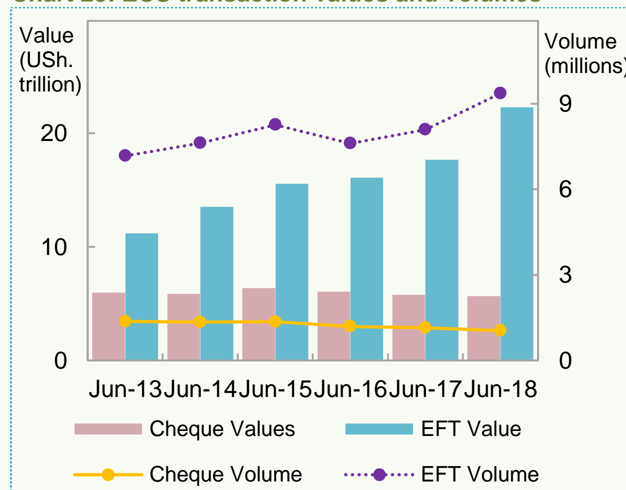
Table 13: UNISS transactions in foreign currencies

Year ended	Jun-16	Jun-17	Jun-18
Total value settled in all foreign currencies (USD millions)	**7,724**	**7,958**	**9,264**
Proportion by currency: Value (%)			
USD	90.7	90.6	91.2
EUR	4.1	3.4	3.7
GBP	0.6	1.1	0.4
KES	4.6	4.7	4.6
TZS	0.1	0.1	0.1
RWF	0.0	0.2	0.0
Total volume settled in all foreign currencies	**118,177**	**127,594**	**127,909**
Proportion by currency: Volume (%)			
USD	93.4	92.7	91.4
EUR	1.9	1.8	2.0
GBP	0.6	0.7	0.8
KES	4.0	4.6	5.6
TZS	0.2	0.2	0.2
RWF	0.0	0.0	0.0

Source: Bank of Uganda

The fully automated clearing house reduces the time required to clear a cheque to two days and will eventually reduce it to a single day, lowers the costs of cheque clearing and also reduces the risks involved in cheque clearing such as fraud. It also provides the entire country with access to a single centralised cheque clearing platform as opposed to the decentralised and unaligned platforms used in the past.

Chart 28: ECS transaction values and volumes



Source: Bank of Uganda

Transactions in Ugandan shillings

In the year to June 2018, 1.1 million cheque transactions valued at USh.5.8 trillion were cleared in the ECS. This was a slight decline from 1.2 million cheque transactions equivalent to a value of USh.6.1 trillion that were cleared through the ECS in the previous year. However, the total volume of EFT transactions increased from 8.6 million recorded in the previous year to 9.4 million in the year ending June 2018. On the same note, the value of the EFTs transactions rose by 21.7 percent from USh.19.1 trillion to USh.23.3 trillion over the same period.

3.1.3. Mobile money payment systems

Currently, there are four mobile network operators (MNOs) providing mobile money services: MTN Uganda through MTN Mobile Money, Airtel Uganda through Airtel Money, Africell Uganda through Africell Money Uganda, and Uganda Telecom through M-Sente. However, there are also non-MNO mobile payments providers, such as M-Cash, Ezee Money, and Micro-pay.

Table 14: Summary of the mobile money services performance

Year ended	June 2017	June 2018	Change (%)
Number of transactions (millions)	1,111.0	1,345.4	21.1
Value of transactions (USh. trillion)	52.8	73.1	38.5
Number of registered customers (millions)	22.9	22.7	-0.7
Number of agents	147,146	166,194	12.9
Balance on customer's accounts (USh. billion)	323.2	496.0	
No. of active customers(90 days)		12,842,833	
Systems uptime (Average % age)		99.7	

Source: Bank of Uganda

Mobile money operations continued to achieve significant growth rates in the year to June 2018. The mobile money network did not encounter any major interruption in the period under review and registered an average systems uptime of 99.7 percent. However, the number of customers declined by 0.7 percent in the year to June 2018 from a growth rate of 16.6 percent in the year to June 2017. This was largely attributed to the de-registration of mobile money accounts whose users had not submitted the requisite know-your-customer (KYC) credentials to maintain their registration status.

3.1.4. Looking forward to the next year

In the year to June 2019, the main focus for BOU will be on implementing the EAC regional harmonised oversight and risk analysis policies for payment systems. BOU is also taking steps to fully comply with the Principles for Financial Market Infrastructures which were issued by the Bank for International Settlements (BIS) in 2012, aimed at helping central banks in ensuring and promoting safe and efficient payment systems and other financial market infrastructures.

3.2. The retirement benefits sector[8]

3.2.1. Overall growth of the sector[9]

The total assets of the retirement benefits sector grew by 17.9 percent from USh.7.8 trillion in 2016 to USh.9.2 trillion in 2017. This growth was mainly influenced by contributions, investment earnings from government bonds, deposits and listed equity. Growth was achieved in the face of several risks including the declining interest rate environment and depressed equity market conditions witnessed in 2017. Investment income increased from USh.760 billion in 2016 to USh.1 trillion in 2017 mainly on account of interest income. The rate of return on the sector's total investment portfolio increased from 12 percent in 2016 to 13.8 percent in 2017. When compared to an average inflation rate of 5.6 percent over the same period, it implies a real rate of return of 8.2 percent was realised.

[8] *The latest data available for the retirement benefits sector is as at end-December 2017.*

[9] *Assets are based on audited financial statements for two reporting periods (30th June 2017 and 31st December 2017) while investments are as at end-December 2017.*

The largest institutions in the sector are the National Social Security Fund (NSSF) and the Parliamentary Pension Scheme (PPS). Both schemes performed satisfactorily in the year to June 2018.

Table 15: Investment portfolio of the retirement benefits sector

Investment type	2016	2017
Total investments (USh. trillion)	**8.0**	**9.9**
Composition (percentage share)	**%**	**%**
Government securities	71.3	71.7
Quoted equities	14.5	15.4
Investment property	5.9	5.3
Fixed deposits	4.2	2.6
Unquoted equities	2.2	2.2
Corporate bonds	1.3	1.3
Others investments *	0.6	1.5

**Other investments include collective investment schemes, unit trusts, guaranteed funds, etc.*
Source: URBRA

National Social Security Fund

The total assets under management of the Fund reached USh.10.0 trillion by end of June 2018 recording a 26 percent growth from USh.7.9 trillion at end of June 2017. The increase was supported by the growth in contributions and investment earnings. Total income increased to USh.1.6 trillion, recording an increase of 77 percent compared to USh.912 billion in the previous year. The rate of return on the Fund's investment portfolio was 16.5 percent, enabling a rate of return of 15 percent to its members. This was on account of investment earnings, operational income and fair value gains from equity investments. Interest income was the major source of income (85.4 percent of the total income) to the Fund.

Parliamentary Pension Scheme

The total assets of the Parliamentary Pension Scheme (PPS) reached USh.155 billion at end-June 2017, recording a 44 percent increase when compared to USh.107 billion at end-June 2016. Total investments amounted to USh.152 billion in 2017, recording an increase of 56 percent, with a return on investment of 17 percent. The increase mainly came from contributions and investment earnings during 2017. Profitability increased with the gross income for the year 2017, rising by 60 percent to USh.23.7 billion, compared to USh.14.8 billion in 2016. Government bonds, deposits and listed equity had the most influence over the changes in the value of the scheme. The highest contributor to income was interest payments which represented 65.8 percent of the total income. Dividends, grant revenue and other income represented 34.2 percent.

Supplementary voluntary schemes

As at-end December 2017, assets of supplementary voluntary schemes came to USh.1.1 trillion, up by 7 percent, accounting for 12 percent of total assets of the sector. The changes in the value of net assets reflect changes in net contributions, increase in value of assets and investment returns. The return on investments of supplementary voluntary schemes was 14.9 percent in 2017 compared to 9.0 percent in the previous year. Given that the structure of voluntary schemes is dominated by fixed income instruments, the return was mainly influenced by interest payments.

3.2.2. Initiatives to develop the sector

In a bid to expand coverage, the Uganda Retirement Benefits Regulatory Authority (URBRA) licensed Mazima Voluntary Individual Retirement Benefits Scheme (MVIRBS) and Kampala City Traders Association (KACITA) Provident Fund to pilot extension of coverage to self-employed workers. Membership to MVIRBS is open to anybody with emphasis on low-income earners. On the other hand, enrolment into KACITA Provident Fund is restricted to members of the Association. The NSSF also introduced a Voluntary Membership Plan which currently has 6,148 subscribers. The Plan targets employers and workers that are not compelled to save by mandatory provisions of the NSSF Act, granting them an opportunity to voluntarily save for their retirement.

3.2.3. Risks in the retirement benefits sector and regulatory actions

The main risks facing the retirement benefit schemes arise from the nature of their operations and mainly include default risk from employers and employees, stock market risk, operational risks and liquidity risk. URBRA has taken several steps to address these risks. First, investment limits were set to ensure portfolio diversification, dilute ownership concentration limits, and to avoid self-investment in a scheme's sponsoring company. Scheme assets must be properly diversified (classes, geography, asset managers, sector risks and underlying securities) to provide greater stability of investment returns and reduce risk.

Secondly, investment limits in assets such as equity which are regarded as more volatile were made tighter. This is premised on the fact that the underdevelopment and lack of transparency of domestic securities markets make them susceptible to manipulation and excess volatility. Thirdly, trustees were also mandated to have appropriate investment governance arrangements to ensure that the risks are properly managed.

Further, URBRA has undertaken a number of prudential actions to enhance regulation and strengthen the sector. Regulations have been prepared that will enhance the operation and management of schemes, winding-up, merger or transfer of retirement benefits and assignment of benefits for mortgages, housing loans and medical treatment. This includes provisions for regulating operations of corporate trustees. Licensing was also strengthened through an Instrument gazetted in July 2017, which introduced provisions on vesting rights of members and exemption of application and licence fees payable by voluntary schemes. In addition, to ensure correct reporting, revised sanctions were introduced for failure to submit financial statements and payment of compulsory levies within the prescribed time. Guidelines on preparation of scheme annual reports, engagement of external auditors, whistle blowing, and fit-and-proper testing were also introduced.

3.3. The insurance sector[10]

3.3.1. Financial performance of the industry

The Insurance Regulatory Authority of Uganda (IRA) reported that the total assets of the industry increased from USh.1,242.1 billion in 2016 to USh.1,439.7 billion in 2017. The largest growth was recorded in the life insurance business which increased by 25 percent over the year. Non-life (general)[11] insurance accounted for 73.1 percent, life insurance accounted for 24.6 percent, while health management organisations[12] (HMOs) accounted for 2.3 percent of total industry assets during the period under review. Despite the considerable growth of the sector, insurance penetration (ratio of gross premiums to GDP) in the sector remained low at 0.8 percent, compared to the African average ratio of 3.0 percent. The low penetration represents an opportunity for the industry to expand their reach in the domestic financial services market.

The growth in the insurance sector was mainly attributed to the increase in the uptake of medical insurance (now the largest class of business) by corporate institutions. Gross written premiums (GWP) for medical insurance grew to USh.161 billion in 2017, up from USh.121 billion in 2016, representing a growth of 33.2 percent. Premiums from various road projects and new infrastructural projects also boosted growth, as did the increase in the uptake of agriculture insurance under the Agriculture Insurance Consortium. As at March 2018, the utilisation of the subsidy was USh.4.8 billion for 59,146 farmers while the GWP from agriculture insurance under the consortium arrangement (subsidy plus farmers contribution) was USh.10.1 billion.

In the year ended 2017, the overall GWP income in the insurance sector increased from USh.634.8 billion in 2016 to USh.728.5 billion in 2017, which

[10] *The latest data available for the insurance sector is as at end-December 2017.*

[11] *General insurance or non-life insurance policies, including automobile and homeowners policies, provide payments depending on the loss from a particular financial event.*

[12] *HMOs provide health insurance.*

represents a 14.8 percent growth. In terms of market composition, non-life insurance contributed 69.6 percent of the total GWP income, and life insurance contributed 23.1 percent while HMOs contributed 7.2 percent. Medical insurance GWPs grew by 33.2 percent from USh.121 billion in 2016 to USh.161 billion in 2017, while non-life GWP income grew by 12.7 percent in 2017 from USh.450.1 billion to USh.507.2 billion. Life insurance business GWP income, on the other hand, grew by 27.2 percent in 2017 from USh.132.4 billion to USh.168.5 billion.

Table 16: Total assets and GWP for the insurance sector (USh. billion)

		Non-life	Life	HMOs	Industry
2015	Total assets	910.0			1,137.5
	Share (%)	80.0			
	GWP	464.4	99.8	48.2	612.4
	Share (%)	75.8	16.3	7.9	
2016	Total assets	917.2	283.6	41.3	1,242.1
	Share (%)	73.8	22.8	3.3	
	GWP	450.2	132.5	52.2	634.8
	Share (%)	70.9	20.9	8.2	
2017	Total assets	1,052.2	353.7	33.8	1,439.7
	Share (%)	73.1	24.6	2.3	
	GWP	507.2	168.7	52.8	728.5
	Share (%)	69.9	23.2	7.2	

Source: IRA

Sector profitability

Non-life underwriting profitability reduced from USh.12.4 billion in 2016 to USh.10.7 billion in 2017. The reduction in underwriting profitability is attributable to the increase in claim pay-outs by the industry. The gross claims paid for life insurance, non-life insurance and HMOs increased by 11.7 percent from USh.261 billion in 2016 to USh.291 billion in 2017.

Adverse losses were registered under the medical class of business due to many factors, including the increase in the cost of treatment which has been largely contributed by the increased prices of drugs that are exposed to currency risk. Medical insurance providers were engaged and advised to tighten their underwriting and pricing strategies in order to achieve better loss ratios.

3.3.2. Analysis of risks to the insurance sector

The risks to financial stability from the insurance sector mainly stem from developments within the sector, such as poor management and lack of commercial viability of many firms in the industry.

Credit risk

Insurance institutions face challenges related to outstanding premium which affects their performance. However, the Insurance Amendment Act (2017) introduced measures regarding the cash-and-carry mode of business, which resolve the issue of outstanding premiums.

Liquidity risk

A number of insurance companies in the market are over-exposed to investment in real estate, which affects their liquidity and hence ability to meet some obligations. IRA engaged the respective insurers to take steps to enhance their liquidity.

Operational risk

Over the last two years, there has been a general rise in insurance fraud and cyber risks which has affected the performance of the industry. To combat this risk, IRA established an anti-fraud unit in order to expose and weed out fraud in the industry. Some of the fraudulent cases handled include forgery of workman's compensation claims and counterfeit motor third party premiums. In addition, IRA has taken steps to enhance compliance with the Anti-Money Laundering Law within the insurance industry.

Overall, the insurance industry's performance declined in the year to June 2018. IRA undertook a number of regulatory measures to address the weaknesses identified, including corrective measures and conducting focused onsite supervision on selected insurance companies. The interventions made by IRA are expected to support improvements in the performance of the insurance sector over the medium-term.

4. The Outlook For Financial Stability

Uganda's financial system remains sound and resilient. Overall, risks to financial stability have eased since the last FSR, with the main concern being the likely impact of plausible external shocks in the short- to medium-term. The banking system continues to hold sufficient buffers of capital and liquidity. This section presents a summary of the risks to the banking system and the outlook for financial stability.

4.1. Overview of systemic risk in the banking sector

Across a range of measures, risks to financial stability of Uganda's banking sector reduced in the year to June 2018. Table 17 provides a summary of the assessment of vulnerabilities within the financial system as drawn from BOU's systemic risk dashboard.

Indicators of liquidity and funding risk reveal that banks have strong liquidity buffers supported by growth in deposits, with the industry's aggregate LCR increasing from 252.9 percent to 372.4 percent. In addition, the cost of funding, both from offshore and domestic sources, has reduced, along with interest rate volatility in the domestic interbank market. Credit risk abated during this period, with the NPL ratio declining to 4.4 percent as at end-June 2018 amidst strong recovery in annual credit growth of 11.9 percent.

Table 17: Overall assessment of systemic risk for the year ending June 2018

Risk category	Risk direction from previous year	Risk drivers and contributing factors
Overall risk	Reduced	- Overall financial stability risk reduced largely as a result of improving macroeconomic conditions. - Continued improvements in economic activity should ease credit risk and improve credit growth in the medium-term.
Macroeconomic risk	Marginal / unchanged	- Improving economic activity driven by the industry sector and a low inflationary environment. - Recent developments in the external sector threaten economic recovery.
Credit risk	Reduced	- Credit growth registered improvement during the year. - Increased write-offs explained the decline in NPLs.
Liquidity risk	Reduced	- Banks continued to maintain sufficient liquid assets.
Market risk	Marginal / unchanged	- Sharp exchange rate depreciation occurred during the first half of 2018. - Nevertheless, banks' exposure to foreign exchange risk remained low. - The low interest rate environment affected the value of long-term trading securities
Profitability & solvency	Reduced	- Income and expense ratios stable on a quarter-on-quarter basis.
Structural risk	Reduced	- Lower asset concentration in the banking industry.
Contagion risk	Increased	- Increased exposure to non-resident banks through nostro deposits.

Key:

↓ Reduced	↔ Marginal / unchanged	↑ Increased

Source: Bank of Uganda

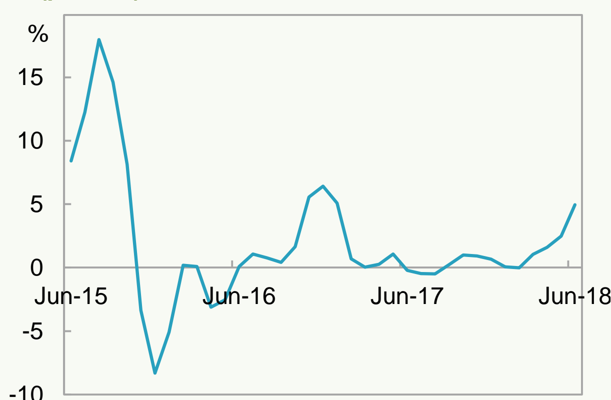
Banking sector profitability was boosted by a sharp fall in NPLs, gains on foreign exchange operations and interest earned on balances held with financial institutions abroad as banks sought to capitalise on the exchange rate volatility and rising interest rates that occurred during the first half of 2018. In response to the higher interest rates, banks shifted their longer term securities from their trading books to holding to maturity, thus reducing their exposure to interest risk arising from increased duration. The combined efforts by banks to maintain adequate liquidity buffers, improve asset quality and diversify income streams resulted in reduced risk to their solvency. Thus, the overall assessment of systemic risk in the financial sector shows that banks' resilience continued to improve in the year to June 2018.

Going forward, the banking system is likely to face some challenges in the form of rising NPLs following easing of lending conditions and the resurgence of credit growth.

4.1.1. External macroeconomic risks

As the IMF's WEO July 2018 update warns, global near-term risks to financial stability have increased somewhat, reflecting mounting pressures in emerging market economies and escalating trade tensions. These risks, while still moderate, could increase significantly going forward, which would affect Uganda's financial sector in two ways. First, a rise in global oil prices could pass through to inflation and eventually heighten credit risk in the banking sector, especially with the anticipated rise in interest rates.

Chart 29: Quarterly changes in the USD/UGX exchange rate (percent)



Source: Bank of Uganda

Secondly, a faster-than-expected tightening in monetary normalisation in advanced economies could further lead to a sharp tightening in financial conditions. Hence, there is the need for banks to put in place appropriate measures to boost their resilience to potential outflows and the related effects on the liquidity in the financial markets.

4.1.2. Domestic risks to financial stability

Credit risk

Domestic inflation has been on upward trend in the quarter to June 2018, and BOU projects core inflation to rise above the target of 5 percent within the next 12 months, driven by rapidly rising oil prices coupled with a weaker shilling exchange rate and increased indirect taxes. These risks could potentially lead to a tightening of monetary policy, which could affect lending rates, increase the debt-servicing capacity of marginal borrowers and thus credit default rates.

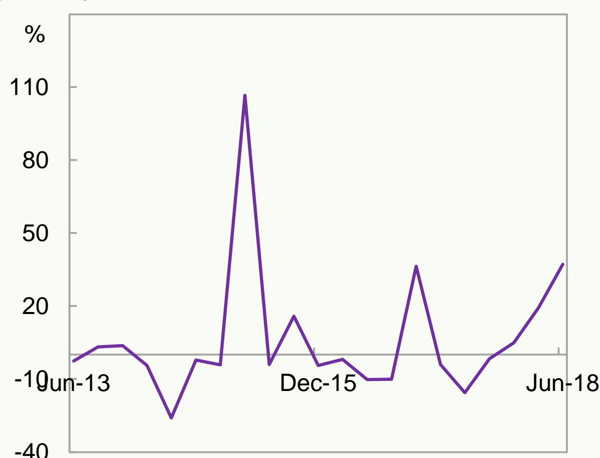
The year to June 2018 registered a recovery in bank lending to the private sector, with total outstanding credit increasing by 11.0 percent. BOU's quarterly bank lending survey reports for the last three quarters to June 2018 indicated that increased lending by banks has been associated with easing of credit standards to all sectors except real estate, which banks attributed to improved macroeconomic conditions, reduction in the monetary policy rate which reduced funding costs, and increased competition in the financial sector, among other factors. The outlook is for loan growth to continue, boosted by an improvement in economic conditions as GDP is projected to grow by 6.5 percent in the year to June 2019.

Impact of rising interest rates

As interest rates started to rise in the first half of 2018, the structure of bank assets changed somewhat. While loans and holdings in government securities maintained the largest share of assets, banks slowed down credit extension in foreign currency, invested less in BOU securities and chose to increase their placements in nostro accounts. Between January 2018 and June 2018, placements

in nostro accounts grew by 63.6 percent, with the largest increase occurring during the quarter ended June 2018. Notably, these placements coupled with the intensification of lending activity during this period resulted in tight liquidity conditions, such that the industry's LCR dropped by 8.7 percentage points to 372.4 percent during the same quarter. This was due to net cash outflows which grew by 28.5 percent compared to high quality liquid assets which declined by 0.3 percent to reach 71.9 percent of banks' total liquid assets, down from 85.1 percent in June 2017.

Chart 30: Quarterly changes in foreign nostro accounts (percent)

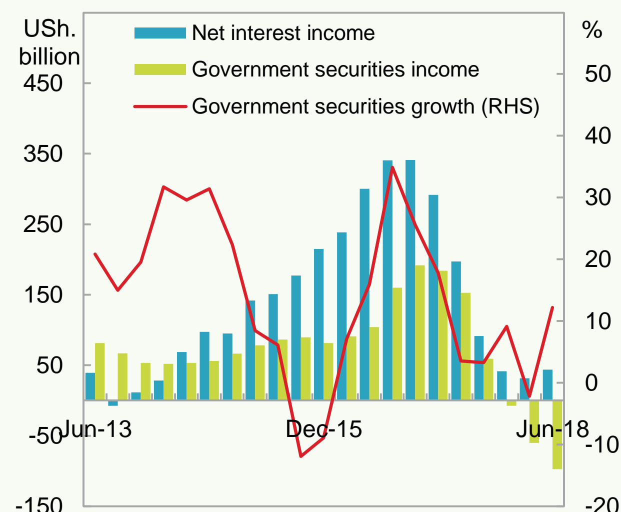


Source: Bank of Uganda

The changes in interest rates during the year also had a significant effect on banks' overall net interest income and in particular, income on their holdings in government securities. Interest income grew slower compared to historical levels, owing to the prolonged low interest rate environment. Despite increased investment in government securities, banks experienced a reduction in income on treasury securities in 2018, possibly due to losses on longer duration bonds as interest rates started to rise. In the year to June 2018, interest income on government securities declined by USh.97.3 billion compared to an increase of USh.152.7 billion in the year to June 2017 (Chart 31).

Going forward, it is expected that as interest rates continue to rise, banks will lock in higher interest rates by buying long-term bonds, continue to hedge against losses on longer duration bonds by investing more in treasury bills and increase lending activity.

Chart 31: Annual changes in banks' interest income



Source: Bank of Uganda

4.2. Stress test results for the banking sector

To assess the resilience of the banking sector to systemic risks including those identified in the preceding section, Bank of Uganda carries out quarterly stress tests. The stress tests are performed using sensitivity analysis in order to determine the impact of individual risk factors on the performance and stability of the banking system. This FSR shows the results of the tests conducted at the end of June 2018 for the following risk factors; credit risk in the form of increased loan default and, liquidity risk presented as the tightening of funding conditions due to potential sudden cash outflows from the banking system.

Table 18: Summary of stress test scenarios

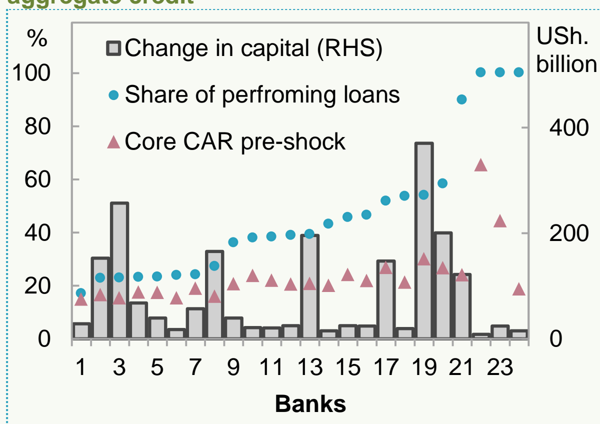
RISK-TYPE	SHOCK
Credit	Assesses the effect of a decline in banks' existing total performing loans
Liquidity	A simulated bank run test on each bank for a 5-day period of stress, which determines if banks would be able to survive a liquidity drain without resorting to funds from external sources The impact of a sudden withdrawal of all deposits held for non-resident financial institutions on the sector's liquidity buffers

4.2.1. Credit risk

The objective of the credit risk stress tests is to assess the effect of a deterioration in loan quality on banks' capital for the next year. A bank is considered to have failed the tests if its core capital adequacy ratio falls below the regulatory minimum of 10 percent, following the impact of the shock. The stress tests do not focus on the origin of the shock, but rather the impact of any given increase in NPLs on banks' solvency.

For credit risk, the stress tests included a shock that tested a uniform deterioration in all banks' aggregate performing loans. The NPL ratio is taken as the main measure of credit risk. Under this scenario, the aim is to derive the share of each bank's performing loans that have to become NPLs before the bank breaches the minimum core CAR requirement. The test assumes constant credit growth for the one-year forecast horizon from June 2018, and all new and existing NPLs are provisioned for according to the regulatory requirements.

Chart 32: Stress test results of shock to banks' aggregate credit



Source: Bank of Uganda

The results of the credit risk scenario show that the least resilient bank, which also had the lowest pre-shock core CAR of 14.9 percent as at end-June 2018, would breach the regulatory minimum core CAR when 17.1 percent of its performing loans become NPLs (Chart 32).

Although the tests do not determine the likelihood of the stated shocks or give an indication of the probability of default on loans, they do reveal that, as at the end of June 2018, the aggregate impact of a deterioration in the banking system's credit portfolio would be mild. The resilience of the banking sector to these shocks is attributed to the high levels of capital held by banks.

4.2.2. Liquidity risk

The resilience of banks to liquidity risk is determined by their ability to withstand sudden adverse liquidity drains without resorting to external liquidity support. For the stress tests for liquidity risk, two scenarios were considered for the period ending June 2018: a simulated run on each bank for a 5-day period of stress, and the sudden withdrawal of all deposits held for non-resident financial institutions. A bank fails the tests if its liquidity ratio falls below the regulatory minimum of 20 percent. In both scenarios, there were no assumptions made about rollovers, increases in borrowings or maturity extensions.

Under the scenario of the bank run, daily withdrawal rates of 5 percent for demand and savings deposits and 3 percent for term deposits are assumed. The results revealed that only two banks would be unable to sustain their liquidity buffers over a 5-day period of distress, suggesting that the majority of banks are currently able to meet sudden short-term deposit obligations and thus are resilient to this type of shock.

The scenario involving the sudden withdrawal of funds belonging to foreign financial institutions was included to test for the risk of a sudden withdrawal of offshore funds. The stress test shows that all banks except one would be able to withstand the loss of offshore funds, with the sector's liquidity ratio reducing from 46.6 percent to 45.2 percent. The results imply that the banking system is currently not vulnerable to this type of shock because it has large liquidity buffers.

4.3. Outlook for financial stability

In the year to June 2018, overall systemic risks to financial stability reduced. Indicators show that there has been a rebound in credit and deposit growth. The banking sector remains well capitalised and with adequate liquidity buffers. However, looking forward,

the banking sector faces several challenges, including the risk of capital outflows, a rise in credit risk from external shocks such as oil prices and a rise in domestic lending rates.

Going forward, it is important that the banking system's resilience does not deteriorate in response to cyclical economic changes, growth in asset prices and global financial conditions. In this regard, Bank of Uganda has taken steps to further strengthen the banking sector regulatory framework. The minimum regulatory core capital adequacy ratio for banks was increased from 8 percent to 10 percent effective May 2018, in a bid to enhance the capital buffers of banks. To address liquidity risk, the Bank has commenced the revision of the Liquidity Regulations to introduce penalties for banks that do not adhere to the minimum LCR requirement of 100 percent. The LCR has also been incorporated into both onsite and offsite supervisory reviews of banks.

5. IMPACT OF THE IFRS 9 ACCOUNTING STANDARD ON THE BANKING INDUSTRY

This chapter provides an update on the status of implementation of the IFRS 9 standard among supervised financial institutions in Uganda including preliminary results on the quantitative impact of the standard on the banking industry. The analysis focuses on changes to provisions for asset impairment and their impact on banks' capital.

5.1. Background

On 1st January 2018, the new accounting standard, International Financial Reporting Standard (IFRS) 9: Financial Instruments, came into effect and all financial institutions are expected to comply with it. The standard was issued by the International Accounting Standards Board in July 2014 to replace International Accounting Standard (IAS) 39; it introduces key amendments in the classification, measurement and impairment of financial assets.

The justification for the IFRS 9 arose from the lessons of the global financial crisis of 2007. The G20 Summit of April 2009 agreed that accounting standard setters should take action to strengthen the recognition of loan impairment and make appropriate provisions by incorporating a broader range of credit information as well as off balance sheet exposures, in order to strengthen bank resilience. In particular, in the years leading up to the crisis, indicators showed that many financial institutions delayed recording impairment of financial instruments, some moved risky exposures off balance sheet, while the treatment of sovereign debt did not reflect the risks that materialised later. As a consequence, when the crisis emerged, banks faced more significant risks and reductions in their capital than was originally anticipated.

5.2. Key amendments introduced by IFRS 9

Classification

The key changes in classification and measurement relate to requirements for entities to classify financial instruments based on their business model and the contractual cash flow characteristics of the instruments. An entity must take into account whether the cash flows generated from the instrument are solely payments of interest and principal, and whether the entity intends to hold the asset to collect contractual cash flows or both to collect contractual cash flows and for sale.

Impairment

IFRS 9 replaces the incurred loss model used under IAS 39 with an expected loss model. This means that, on origination of a financial asset, an entity must recognise a 12-month expected credit loss and subsequently recognise lifetime expected credit losses, if there has been a significant increase in credit risk since initial recognition.

Notably, the expected loss model includes off-balance sheet items as well as sovereign debt securities which were previously excluded in IAS 39 impairment computations. Institutions are required to use key judgment in determining whether there has been a significant increase in credit risk. Additionally, institutions must include forward-looking information, such as macroeconomic forecasts, in the computation of expected credit losses.

5.3. Status of implementation of IFRS 9 by supervised financial institutions and preliminary results

BOU issued a circular to Supervised Financial Institutions (SFIs) in July 2017 instructing them to prepare for IFRS 9, and to send a quarterly report to BOU indicating the likely impact of IFRS 9 on their capital and profitability. In April 2018, BOU further required all SFIs to submit a report on the status of implementation of the new standard as at June 2018, and to ensure that the results are from a model that was verified by an external auditor.

Overall status of implementation

The reports from banks as at June 2018 show that they are at varying stages of implementation, with some more advanced than others. Analysis of the

quantitative impact indicated that IFRS 9 provisions were higher than the regulatory provisions under the Financial Institutions Act (FIA), 2004. However, the banking industry was adequately capitalised and profitable to absorb the additional provisions.

Modelling of expected losses

All banks complied with the BOU requirement to have their models verified by an external auditor. However, reports showed that many banks lacked the internal expertise to develop the requisite models and forecast expected credit losses. There is still significant reliance by some banks on external companies to develop models and to estimate IFRS 9 provisions.

Impact of IFRS 9 on provisions

The reports submitted by banks show that as at June 2018, industry provisions computed under IFRS 9 were USh.683.5 billion while required provisions under FIA were USh.461.9 billion, giving a difference of Ush.221.5 billion.

Under FIA, banks are only required to provision for any asset or off balance sheet item that contains credit risk such as, loans, overdrafts or advances while under IFRS 9, other on- and off-balance sheet items as well as sovereign debt securities are provisioned for. The largest share of IFRS 9 provisions was for loans and off-balance sheet items. The distribution of the provisions under IFRS 9 is summarised in Table 19.

Table 19: Distribution of provisions under IFRS 9

Industry provisions as per IFRS 9	Share (%)
Loans and advances	93.1
Placements in other financial institutions	0.1
Government securities	0.8
Other on-balance sheet items	1.2
Off-balance sheet items	3.4

Source: Bank of Uganda

Regarding the distribution of provisions among different banks as at June 2018, fourteen banks had higher provisions under IFRS 9, while nine banks reported decreased impairment provisions. The higher industry provisions were mainly driven by large banks, whose provisions were higher by USh.242 billion under IFRS 9.

Under FIA, loss assets are to be written off against accumulated provisions within 90 days of being identified as loss, unless approval of the central bank to defer write-off has been obtained. Contrary to this, the IFRS 9 allows for assets to remain on the books if the institution deems the asset still recoverable. This accounts for the higher provisions under IFRS 9 as they were derived from a larger loan book portfolio, including loans previously written off under FIA. Medium-sized banks had fewer provisions under IFRS 9 by USh.25.3 billion, while small banks had more provisions under IFRS 9 by USh.4.5 billion.

Impact of IFRS 9 on capital adequacy and profitability

After accounting for changes under IFRS 9, the industry core capital adequacy ratio at June 2018 was 20.3 percent, compared to 19.9 percent under FIA. Regarding profitability, profits before taxes were USh.510.3 billion under IFRS 9, compared to USh.512.0 billion under FIA, a difference of USh.1.7 billion.

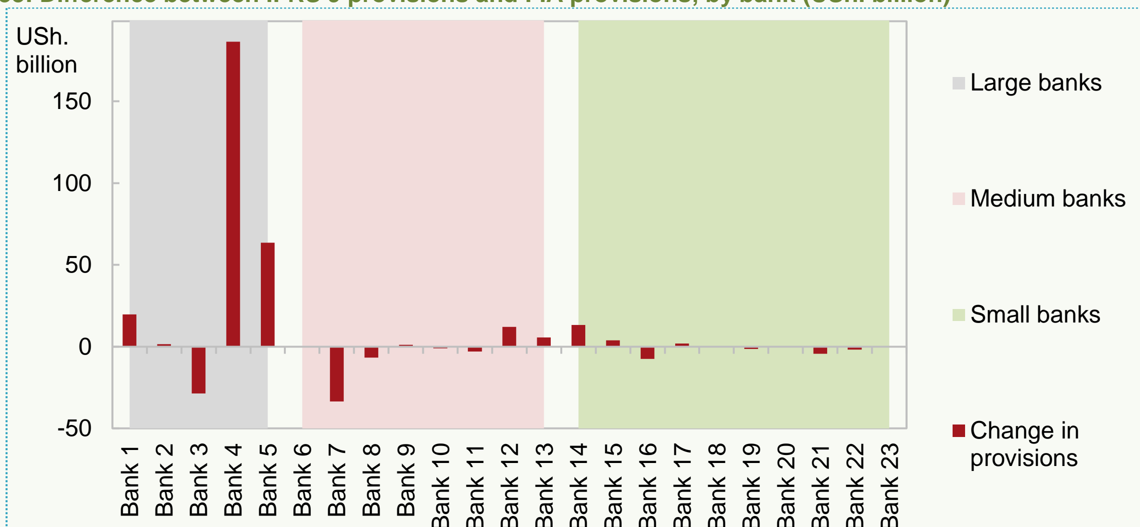
The reason why capital under IFRS 9 was higher than that under FIA, in spite of higher provisions, was because several banks made additional adjustments to recognition of profits under capital. For example, under FIA financial institutions are required to recognise only 50 percent of profits within core capital whereas this restriction does not exist under IFRS 9 regulations.

The effect of the IFRS 9 accounting adjustments on profit and capital was different across banks. The implication is that the above impact should only be taken as preliminary. A clearer picture on the impact of IFRS 9 on capital and profitability will emerge once banks' IFRS 9 accounts are audited for compliance with reporting standards.

5.4. Challenges arising from the preliminary analysis

The preliminary reports from banks show that they have faced several challenges in implementing IFRS 9, mainly centred on variations in business model assumptions and data inconsistencies; the key issues are outlined in Table 20.

Chart 33: Difference between IFRS 9 provisions and FIA provisions, by bank (USh. billion)



Source: Bank of Uganda

Table 20: Challenges observed in the implementation of IFRS 9

1	**Variations in business model assumptions**
	There are variations in model assumptions made by the banks. For example, some banks provided for impairment provisions for government securities and placements in other financial institutions, whereas others did not. This makes comparability difficult.
2.	**Internal capacity**
	Some banks are reliant on external consultants and do not yet have the requisite internal capacity to adequately model expected losses.
3	**Data gaps and inconsistent accounting adjustments**
a.	Different accounting adjustments across banks provided for varying effects no profits and capital. Examples of various adjustments that affected trends across banks included adjustments for CRR, adjustments for interest in suspense, adjustments for written off loans.
b.	IFRS 9 is data intensive and some banks have not yet obtained the detailed data for effective modelling. Whereas most banks provided a detailed breakdown of impairment for financial assets, some made aggregate assumptions for which they are unable to provide a breakdown.

5.5. Conclusion and way forward

It was generally expected that the new impairment model as provided by IFRS 9 would increase industry-wide provisions, due to the change from a backward-looking approach to recognising impairment provisions to a forward-looking approach based on expected credit losses.

Analysis of preliminary accounts as at June 2018 shows that IFRS 9 provisions are higher than those under FIA. The impact on capital appears to be mild but it is too early to get a clearer picture until audited accounts are available. However, the preliminary impact on capital also differs across the banks, being high in some banks and lower in others. In addition, many banks still face capacity and data related challenges.

As a way forward:

- All supervised financial institutions must make an effort to complete implementation of the BOU guidelines on IFRS 9, including capacity development, compilation of good quality data to facilitate the expected credit loss models, and increased transparency for purposes of regulation. BOU will continue to monitor the institutions' IFRS 9 implementation process and provide guidance as and when the need arises to ensure a smooth transition.
- BOU is working with EAC partner-state central banks through the Monetary Affairs Committee to harmonise policies on introduction and implementation of IFRS 9 in the region and ensure that there is no regulatory arbitrage.

6. STATISTICAL APPENDICES

6.1. Selected quarterly financial soundness indicators for East African countries (percentage ratios)

		June 2016	Sept. 2016	Dec. 2016	Mar. 2017	June 2017	Sept. 2017	Dec. 2017	Mar. 2018	June 2018
Regulatory Capital to Risk-Weighted Assets	Uganda	21.7	22.5	19.8	22.8	23.6	23.8	23.2	23.8	21.8
	Kenya	18.1	19	18.7	19.4	19.6	18.8	18.5	18.7	18
	Tanzania	19.2	19.1	19.9	20.8	20.3	20.9	20.5	20.8	20.2
	Rwanda	23.3	22.2	21.9	21.2	20.8	22.3	21.4	21.1	21.4
	Burundi	20.8	20.2	22.4	23.3	21.8	21.8	23.5	24	22.7
NPLS to Total Gross Loans	Uganda	8.3	7.7	10.5	6.3	6.2	7.2	5.6	5.3	4.4
	Kenya	8.4	8.8	9.1	9.6	9.9	10.4	10.6	11.8	12
	Tanzania	8.7	9.1	9.6	11	11	10.6	12.5	11.5	10.3
	Rwanda	7	7.4	7.6	8.1	8.2	7.7	7.6	6.8	6.9
	Burundi	19.2	19.5	21.6	13.7	19.2	14.2	14.6	14.1	13.4
Return on Assets (ROA)	Uganda	2.2	2.4	1.3	1.4	1.7	1.5	2.7	2.6	2.8
	Kenya	3.2	3.3	3.1	2.9	2.8	2.6	2.7	2.9	2.8
	Tanzania	3	2.5	2.3	2.4	2.2	2	1.4	2	1.6
	Rwanda	1.7	1.9	1.7	1.8	1.7	1.6	1.1	1.3	1.6
	Burundi	0.8	0.8	1.8	0.5	0.8	1.9	2	0.8	1.2
Return on Equity (ROE)	Uganda	13.8	14.9	8.3	8.3	10.2	8.7	16.4	15	16.7
	Kenya	27.2	27	24.8	22.2	22.3	20.6	20.8	22.9	23.7
	Tanzania	15.3	12.1	10.7	11.2	10.3	8.7	5.9	8.5	6.7
	Rwanda	9.2	10.1	8.8	10	9.6	8.9	6.2	7.5	9.6
	Burundi	5.3	5.6	11.2	4.7	5.2	14.5	14.9	5.8	9.1
Net open position in FX to Total capital	Uganda	-6.2	-7.1	-8.5	-8.1	-7	-5.5	-5.4	-7.9	-7.3
	Kenya	2.7	4.7	4	3.2	3.8	2.7	4.5	2.6	3.1
	Tanzania	1.4	-2.4	-2	2.2	1.5	2.1	2	0.8	3.3
	Rwanda	-1.8	-6.3	-7	-7.4	-6.1	-7.2	-7.8	-4.5	-22.4
	Burundi	-0.6	-1.2	2.5	-2.8	12.1	0.5	1.5	7. 8	6.2
Liquid assets to total deposits	Uganda	43.4	45.4	51.5	48.8	50.1	48.3	54.6	52.9	46.6
	Kenya	40.4	42.9	41.4	43.8	44.7	49.6	47.4	49.7	50.5
	Tanzania	37.1	34.2	35.8	36	45.1	47	48.6	47.6	45.4
	Rwanda	42.8	42.3	42.5	43.3	44	43.7	43.7	38.2	32.7
	Burundi*	50.8	55.5	55.5	60.7	18.4	19.8	24.4	21.7	19.8

**Liquid asset- to-deposits ratio for Burundi June 2016 to March 2017 derived from IMF open FSI data*

Source: EAC central banks

6.2. Commercial banks' quarterly financial soundness indicators (percentage ratios)

	June 2016	Sept. 2016	Dec. 2016	Mar. 2017	June 2017	Sept. 2017	Dec. 2017	Mar. 2018	June 2018
Capital adequacy									
Regulatory capital to risk-weighted assets	21.7	22.5	19.8	22.8	23.6	23.8	23.2	23.8	21.8
Regulatory tier 1 capital to risk-weighted assets	19.0	19.8	17.3	20.4	21.4	21.5	20.9	21.5	19.7
Leverage ratio	10.8	11.1	9.6	11.0	11.4	11.3	11.2	11.7	11.1
Asset quality									
NPLs to total gross loans	8.3	7.7	10.5	6.3	6.2	7.2	5.6	5.3	4.4
NPLs to total deposits	5.8	5.4	7.4	4.1	4.0	4.6	3.6	3.4	2.8
Sectoral distribution of gross loans (%)									
Agriculture	9.8	9.7	9.8	11.2	11.3	11.6	12.4	12.5	12.2
Mining and quarrying	0.6	0.5	0.5	0.6	0.6	0.7	0.7	0.5	0.7
Manufacturing	14.6	13.9	13.7	13.0	13.3	13.1	12.6	12.6	13.2
Trade	17.9	18.6	18.6	18.8	18.9	19.5	18.7	18.0	19.2
Transport and comm.	7.1	7.4	7.5	7.0	6.8	6.0	6.0	6.3	5.4
Building and construction	23.6	23.4	23.4	20.7	20.5	20.3	20.5	20.6	20.1
Personal loans	15.9	16.6	16.5	18.1	18.5	19.0	18.6	18.7	18.9
Others	10.4	10.0	10.0	10.7	10.0	9.9	10.4	10.9	10.3
Large exposures to total capital	121.5	118.7	133.2	99.8	97.5	95.2	94.8	90.6	113.7
Earnings & profitability									
Return on assets	2.2	2.4	1.3	1.4	1.7	1.5	2.7	2.6	2.8
Return on equity	13.8	14.9	8.3	8.3	10.2	8.7	16.4	15.0	16.7
Net interest margin	11.9	12.3	12.8	12.7	12.3	11.8	11.6	11.6	11.5
Cost of deposits	3.4	3.4	3.5	3.3	3.1	3.0	2.8	2.7	2.5
Cost to income	78.4	77.0	84.8	84.1	81.6	82.9	74.0	74.8	72.8
Overhead to income	47.9	47.5	47.5	47.7	48.4	49.1	48.9	50.3	51.2
Liquidity									
Liquid assets to total deposits	43.4	45.4	51.5	48.8	50.1	48.3	54.6	52.9	46.6
Total loans to total deposits	70.2	70.1	70.8	65.4	64.2	63.9	64.1	64.6	63.3
Market sensitivity									
Foreign currency exposure to regulatory tier 1 capital	-6.2	-7.1	8.5	-8.1	-7.0	-5.5	-5.4	-7.9	-7.3
Foreign currency loans to foreign currency deposits	77.5	75.6	79.3	73.4	72.1	70.8	71.5	70.6	62.9
Foreign currency assets to foreign currency liabilities	96.7	96.0	99.2	96.7	91.8	90.6	92.4	98.3	99.9

Source: Bank of Uganda

6.3. Commercial banks' quarterly balance sheet (USh. billion)

	June 2016	Sept. 2016	Dec. 2016	Mar. 2017	June 2017	Sept. 2017	Dec. 2017	Mar. 2018	June 2018
ASSETS (USh. Billion)									
Cash & cash assets	698.3	708.7	810.8	743.3	809.4	835.2	1,109	841.5	902.8
Balances with BOU	2,727.7	2,582.7	2,858.7	2,945.1	2,917.3	2,790.4	2,544.5	2,219.2	2,880.1
Due from financial institutions	2,244.8	2,074.6	2,592.3	2,527.1	2170	2,124.1	2,049	2,365.9	3,107.2
Government securities	4,965.8	5,262.2	5105.3	5,349.3	5,141.8	5,435.1	5,570	5,232.1	5,776.5
Total gross loans & advances	10,907.2	11,022.1	11,493.2	10,817.2	11,009.1	11,220.7	11,661.6	11,669.5	12,216.5
LESS: Provisions	-570.6	-519.1	-820.2	-352.5	-351.6	-432.3	-410.5	-377.2	-324.9
Net loans & advances	10,336.6	10,503	10,673	10,464.8	10,657.5	10,788.4	11,251.1	11,292.3	11,891.6
Net fixed assets	992.5	1,003	838.5	942.2	818.6	809.6	819	840.9	852
Other assets	776.2	804.9	810.6	1,234.7	2,332.3	2,812.8	3185.4	3213.3	1,962.7
TOTAL ASSETS	**22,794.4**	**22,990.4**	**23,689.2**	**24,206.4**	**24,846.9**	**25,595.7**	**26528.1**	**26,005.3**	**27,373**
LIABILITIES (USh. Billion)									
Deposits	15,538	15,726.6	16,235.7	16,550.2	17,141.8	17,554.8	18,181.1	18,056.6	19,286.6
Due to financial institutions	526.5	575.8	595.5	658.4	594.2	607.6	499.4	560.9	565.8
Administered funds	1,194.6	1,068.2	1,063.3	1,019.3	1,108.6	1,295.88	1,283.9	896	895.9
Other liabilities	1,812.5	1,653.3	2,132.8	1,879.4	1,782.7	1,741.5	1,890.4	1,807.7	1,979.1
TOTAL LIABILITIES	**19,071.8**	**19,024**	**20,027.4**	**20,107.3**	**20,627.4**	**21,199.7**	**21,854.8**	**21,321.2**	**22,727.3**
CAPITAL (USh. Billion)									
Paid-up capital	1,391.3	1,410	1,414.6	1,221	1,255.8	1,296.2	1,326.5	1,326.5	1,332.8
Share premium	145.9	145.9	145.9	317.4	317.4	317.4	347.8	347.8	347.8
Retained reserves	1,775	1,781.7	1,578.5	2,161.3	2,109.8	2,050.3	2,053.5	2,578	2,400.3
Other reserves/subordinated debt	196.1	195.1	218.9	214.4	229.9	248.2	272.7	270.9	192.1
Profit – Loss (current year)	214.2	433.7	303.9	185	306.6	483.9	672.8	160.9	372.6
TOTAL SHAREHOLDERS' FUNDS	**3,722.6**	**3,966.4**	**3,661.8**	**4,099**	**4,219.5**	**4,395.9**	**4,673.3**	**4,684.1**	**4,645.7**
OFF BALANCE SHEET ITEMS (USh. Billion)									
Letters of Credit	390	353.5	337.2	292.2	336.3	359.3	348.6	380.7	483.2
Guarantees & performance bonds	2,280.5	2,368.5	2,548.1	2,666.8	2,874.1	2,979	3,176.4	3,161.1	3,627.9
Unused loans/overdrafts commitment	2,020.7	2,347.8	2079	1,961.6	1,838.6	1,906.1	2,407.2	2,139.5	2,725.6
Other off balance sheet items	97.6	281	148.4	318	466.2	550.3	362.9	390	359.7
TOTAL OFF BALANCE SHEET ITEMS	**4,788.8**	**5,350.8**	**5,112.7**	**5,238.6**	**5,515.3**	**5,794.6**	**6,295**	**6,071.3**	**7,196.3**

Source: Bank of Uganda

6.4. Commercial banks' quarterly income statement, year-on-year figures

	June 2016	Sept. 2016	Dec. 2016	Mar. 2017	June 2017	Sept. 2017	Dec. 2017	Mar. 2018	June 2018
INCOME (USh. Billion)									
Interest income									
Advances	1,839.8	1,855.6	1,868.8	1,849.7	1,826.3	1,809.2	1,808.0	1,823.4	1,843.8
Government securities	570.1	641.4	689.3	715.6	722.9	700.6	681.9	655.5	625.6
Deposits abroad	14.9	16.0	17.3	17.8	19.2	20.2	22.2	24.2	28.8
Other	95.1	109.7	117.7	122.1	125.6	137.5	151.7	163.7	163.3
Charges, fees & commissions	436	432.1	429.9	435.7	493.1	511.7	533.8	541.2	500.0
Foreign exchange income	264	223.5	219.7	202.5	171.7	169.4	170.6	188.0	225.8
Other income	267.6	278.9	261.1	269.0	274.5	296.9	323.7	296.7	293.0
TOTAL INCOME	**3,487.5**	**3,557.2**	**3,603.8**	**3,612.4**	**3,633.3**	**3,645.6**	**3,691.9**	**3,692.6**	**3,680.2**
EXPENSES (USh. Billion)									
Interest expense on deposits	509.2	526.7	539.6	526.7	513.5	499.5	480.3	465.5	449.4
Other interest expenses	189.6	178.0	169.3	165.5	162.1	158.9	157.7	156.5	149.6
Provisions for bad debts	364.1	345.2	637.2	624.5	531.1	571.5	285.4	280.4	196.0
Salaries, wages, staff costs	684.5	695.8	720.1	736.3	748.4	768.6	773.9	786.1	800.6
Premises, depreciation, transport	321.7	324.1	322.2	324.7	325.8	326.3	328.9	332.3	338.5
Other expenses	664.0	667.5	668.4	660.8	683.6	695.7	704.1	740.6	744.5
TOTAL EXPENSES	**2,733.0**	**2,737.3**	**3,056.8**	**3,038.5**	**2,964.4**	**3,020.5**	**2,730.2**	**2,761.4**	**2,678.6**
ADD: Extraordinary credits/charges	0.0	- 1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net profit before tax	754.5	818.9	546.0	572.9	667.8	625.1	961.7	931.1	1,001.6
LESS: Corporation tax	268.8	263.7	243.9	250.3	263.3	262.9	278.7	272.2	263.3
NET PROFIT AFTER TAX	**485.6**	**555.1**	**302.1**	**322.6**	**404.5**	**362.2**	**683.0**	**658.9**	**738.3**

Source: Bank of Uganda